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CITATIONS

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In the Supreme Court of the United States

OCTOBER TERM 1948

Nos. 226, 227, 243

SECURITIES AND EXCHANGE COMMISSION, THOMAS W. STREETER, ET AL., THE HOME INSURANCE COMPANY AND TRADESMANS NATIONAL BANK AND TRUST COMPANY, PETITIONERS

v.

CENTRAL-ILLINOIS SECURITIES CORPORATION, C. A. JOHNSON, LUCILLE WHITE AND FRANCIS BOEHM

No. 266

CENTRAL-ILLINOIS SECURITIES CORPORATION AND CHRISTIAN A. JOHNSON, PETITIONERS

v.

SECURITIES AND EXCHANGE COMMISSION, ET AL.

ON PETITIONS FOR WRITS OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

BRIEF FOR THE SECURITIES AND EXCHANGE COMMISSION

OPINIONS BELOW

The opinion and judgment of the court below (R. 12), and the opinion denying petitions and

cross-petitions for rehearing (R. 138) are reported at 168 F. 2d 722. The opinion of the district court is reported at 71 F. Supp. 797 (R. 283a). The findings and opinions of the Commission dated December 4, 1946, and January 8, 1947, have not yet been officially reported but are set forth in the Commission's Holding Company Act Release Nos. 7041 (R. 25a) and 7119 (128a).

JURISDICTION

The judgment of the Circuit Court of Appeals for the Third Circuit was entered on March 19, 1948 (R. 41). Petitions and cross-petitions for rehearing were denied on June 11, 1948 (R. 138). The Commission petition for a writ of certiorari was filed August 16, 1948, and granted on October 25, 1948 (R. 143). The jurisdiction of this Court is invoked under 28 U. S. C. 1254 made applicable by Section 25 of the Public Utility Holding Company Act of 1935, 49 Stat. 803 (15 U. S. C. 79 *et seq.*)

STATUTE INVOLVED

The applicable provisions of the Public Utility Holding Company Act of 1935 and of Section 77 of the Bankruptcy Act are set forth in Appendix A, *infra*.

QUESTIONS PRESENTED

The holding company which is being liquidated in compliance with Section 11 is solvent. Under its charter, the three classes of preferred stock

have call or redemption prices higher than their involuntary liquidation preferences. Each of the three classes of preferred shares has an investment value at least equal to the call price. The following questions are presented:

1. Did the Commission properly apply the "fair and equitable" standards of Section 11 (e) of the Public Utility Holding Company Act as interpreted in *Otis & Co.* v. *S. E. C.*, 323 U. S. 624, in approving a plan which would pay to the preferred stockholders cash equal to the current going concern value of their shares but not in excess of the call price, where this amount exceeds the involuntary liquidation preference of such shares?

2. Did the Commission and the courts below properly hold that under the *Otis* case the involuntary liquidation preference of the preferred stocks is not a controlling determination of what the preferred stockholders should receive under the instant plan?

3. Where a plan under Section 11 (e) of the Public Utility Holding Company Act is enforced in a district court and there is no dispute as to the sufficiency of the evidence upon which the Commission based its finding of fairness, is the court authorized to reject such finding on the basis of a discretionary weighing of equities and without reference to the generally recognized

limitations upon the scope of judicial review of policy and fact finding functions of the agency?

4. If the Commission erred, is remand necessary under the circumstances of this case?

STATEMENT

This case involves a plan filed under Section 11 (e) of the Public Utility Holding Company Act of 1935 by Engineers Public Service Company ("Engineers"). The plan contemplated *inter alia* satisfying the claims of Engineers' preferred stockholders in cash as a preliminary to distributing its remaining assets to common stockholders and dissolving. In addition to $14,650,000 in cash and U. S. treasury securities, Engineers' assets consisted chiefly of 99.8 per cent of the common stock of Virginia Electric and Power Company ("Virginia"), all of the common stock of Gulf States Utilities Company ("Gulf States"), and all of the common stock of El Paso Electric Company ("El Paso"). The only substantial controversy before the Commission, and the question upon which the Commission and both courts below have differed, related to the application of the "fair and equitable" standard of Section 11 (e) to the treatment accorded the preferred and common stockholders. The other aspects of the plan raised no important dispute and have been consummated, reserving the

present issue through an "escrow" arrangement which set aside the funds in dispute.[1]

Engineers had no debt outstanding, but had three series of cumulative preferred stock of equal rank: 143,451 shares of $5 series, 183,406 shares of $5.50 series, and 65,098 shares of $6 series. The plan as originally formulated and filed by the company's management, which was controlled by common stockholders,[2] proposed in

[1] This Court has previously been advised of the partial consummation of the plan as mooting the cases then pending upon cross petitions of the Commission and of Engineers to review the decision of the United States Court of Appeals for the District of Columbia, 138 F. 2d 936, which upheld in part determinations of the Commission under Section 11 (b) (1). That decision was vacated as moot. 332 U. S. 788.

[2] Counsel had advised Engineers' directors that—

"Although, as will appear, I am unable with assurance to advise you that the premium is not payable, I have no hesitancy in advising you that, as directors, I think you should, for your own protection, take the position that the premiums are not payable. This is so because if you should, as a Board, voluntarily pay the premiums and it should later, as the law on the subject develops further, be determined that the premiums were not payable, it is possible that you might incur liability to the common stockholders on the ground of waste of assets" (R. 1725a).

One director, Kellogg, who agreed that preferred stockholders should receive only $100 per share objected that "the Board should honestly apply their best judgment to the case without fear that their good faith would be questioned" (R. 1962a). President Barnes agreed with counsel that if "there is any doubt as to whether the preferred stockholders are entitled to a premium, the Directors would be guilty of wasting the assets if they voluntarily paid the premium" (R. 1965a).

general to pay preferred stockholders only the amount of their involuntary liquidation preference, which was $100 a share and accrued dividends for each series of preferred stock, to distribute the remaining assets to the common stockholders,[3] and to dissolve.[4] In order to assure an adequate presentation of the preferred stockholders' point of view, the Board of Directors authorized a member primarily interested in the preferred stock (Streeter) to employ counsel partially at the company's expense. That director and members of his family are the petitioners in No. 227. There also appeared before the Commission representatives of a group of institutions which held preferred stock (Home Insurance Company, et al., petitioners in No. 243). The preferred stockholders' representatives appeared in opposition to the plan and contended that they should receive $105 for the $5 series and $110 for the $5.50 and $6.00 series, amounts which were equal to the voluntary liquidation preferences and the redemption prices, specified in the charter. The possibility

[3] Gulf States was to be distributed pursuant to a rights offering program entitling Engineers' common stockholders to one share of Gulf States for each share of Engineers common held at a subscription price of $11.50 per share.

[4] At first Engineers proposed, in the alternative, that after paying off the preferred it would dispose of its interests in Gulf States and El Paso and merge with Virginia. The merger alternative was removed during the hearings on the plan.

that Engineers would be required to pay the preferred amounts equal to the voluntary liquidation preference and redemption price of the stock had been recognized from the start, and it was likewise recognized that it was advantageous from the common stockholder's point of view to go forward with the plan irrespective of how that issue might be ultimately determined (R. 719a, 723a, 807a).

All the testimony adduced, by both the preferred stockholders and management, valued the preferred stocks on a going concern basis at figures in excess of their voluntary liquidation preferences and redemption prices. Dr. Ralph E. Badger, an expert witness called by the preferred stockholders, in an exhaustive and detailed analysis (R. 2088a), concluded that, apart from their call provisions, and on the basis of quality and yield, the three series of preferred should be valued at $108.70, $119.57, and $130.33, respectively. Even the president of Engineers, Mr. Barnes, testified that the preferred stocks would have been refinanced and retired by call if it were not for the impact of Section 11, and that on a going concern basis the stocks should sell above their redemption prices (R. 522a, 658a–663a). Barnes agreed that apart from the impact of Section 11, and taking into account the redemption prices, the fair value for the preferreds, meaning "what a willing buyer

would pay and what a willing seller would take in today's market for such securities", would be somewhat above the redemption prices (R. 522a). Barnes referred to possibilities of inflation, depression, government competition, adverse changes in regulatory policy, or developments in the field of atomic energy which might in the future cause Engineers' preferred stocks to sell below "this top level". These factors, he conceded (R. 525a), "are common to the utility industry generally * * * so that present price levels of securities reflect the extent to which the investing public is presently appraising these hazards. * * *" Although Badger and Barnes characterized the preferred stocks differently, Badger using the term "medium grade" (R. 1133a) and Barnes using the term "closer to a low-grade preferred" (R. 1140),[5] they

[5] In the context of their testimony it is clear that both witnesses were characterizing as "high grade" preferred stocks having such a low risk factor as to sell upon a yield basis approaching high grade, long term bonds. Badger expressed the opinion in the light of the then current yields for other preferred stocks which he regarded as comparable that a proper yield for the Engineers preferred, absent a call price, would be 4.6% (R. 1062a–1063a, 2118a). His valuation figures given in the text are the mathematical results of applying this yield basis. Badger referred to a Standard Statistics report on the yield of high grade bonds disclosing that they had dropped from a 5.28 per cent basis in 1932 to a 2.7 per cent basis in 1945, and that the yields on high grade preferred stocks had dropped from a 6.13 per cent basis in 1932 to a low level of 3.65 per cent in 1945, pointing to individual high grade preferred stocks selling to yield as low as 3½ per cent (R. 1017a). Badger also testified to his belief

agreed, as Engineers stated in its brief before the Commission, that "the present value or investment worth of these three series of stock, on a going concern basis and apart from the Act, under prevailing yields applied to comparable securities" was in excess of the respective call prices (R. 67a, see also R. 1211a, 1953a). Other evidence in the record also confirmed the position of the preferred. For example, the financial statements disclosed that, as of June 30, 1945, each share of preferred stock had an asset coverage of $218.11.[6] From the point of view of income which the Commission emphasized; the average coverage of fixed charges and preferred dividends by the system over the five years preceding 1945 was 1.4 times and preferred dividend requirements were earned an average of 1.5 times over the same period on a corporate basis (R. 64a).

Applying the Holding Company Act standards, which required the payment to the stockholders to be the fair and equitable equivalent of what was surrendered, the Commission considered all the charter rights being surrendered by the pre-

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that the low money rates which were an element in his valuations were likely to continue in the foreseeable future. (R. 1064a). This prophecy was disputed by Engineers. The Commission did not prophesy as to the future course of the money markets since it directed its inquiry to an evaluation of the Engineers preferred as of the time its decision was rendered.

[6] Even if the entire unrestricted surplus were used to pay dividends to the common stock the preferred would still have an asset coverage of $194.91.

ferred, including the right to receive annual dividends of $5, $5.50, or $6.00 per share in perpetuity or until redemption or the liquidation of the company, the remoteness of the possibility of involuntary liquidation in view of the asset coverages and equity value of the stock, and the right to $105 or $110 per share, depending on the series, in the event of voluntary liquidation or redemption. The Commission determined, in accordance with the undisputed testimony, that the current worth of the preferred, or its "investment value" on a going concern basis, was at least equal to the respective call prices.[7] It thereupon concluded, on the basis of its own analysis of the record, that it was not fair and equitable to pay the preferred any less than the call prices, which fixed a "ceiling" upon their claims. The Commission did not find it necessary to determine what the preferred stocks would be worth in the absence of a call price.

The common stock was then considered under the same standards of the Act, and as a residual equity interest, with a right to assets or dividends

[7] The figures before the Commission covered actual earnings through June 1945. At the time of oral argument before the Commission, September 5, 1946, counsel for Engineers advised the Commission that there had been no material change in the earnings picture, and that the management's estimates of earnings for the year 1946, which were slightly higher, and which "the Commission can consider * * * admissions against interest," had proved on the conservative side in the light of experience (R. 1282).

only after the preferred was satisfied. It was determined that the plan, in according to the common the entire interest in the enterprise after the retirement of the preferred stock, satisfied those standards. The Commission noted that "the fair and equitable" standard being one of absolute priority "requires that full compensation be given the senior securities before any payment or participation is permitted to the junior securities," making it necessarily fair to the common, in the absence of other circumstances, to give them everything that was left after according fair treatment to the preferred (R. 73a). The Commission found that "the retirement of the preferred stock will be of immediate benefit to the common stockholders" (R. 69a).[8] The Commission found it unnecessary, however, to place a dollar valuation upon the interest the common stockholders received and surrendered.

In considering the charter rights of the preferred stock, the Commission agreed with Engineers that the proposed liquidation did not make applicable the charter voluntary liquidation preferences as dispositive of preferred stockholders' claims since the proposed liquidation was "caused by the Act and is in that sense 'involuntary'"

[8] The management had made it clear that they regarded the plan as desirable from the point of view of the common stockholders whether or not it should be held necessary to pay the preferred amounts equal to their voluntary liquidation preferences redemption prices (R. 719a, 723a, 807a).

(R. 61a).[9] This holding accords with a long line of Commission and court precedents under which bonds and preferred stocks have been retired in liquidations required by Section 11 without treating such a liquidation as necessarily requiring payment of the call price.[10] The Commission rejected Engineers' contention that because the liquidation was not "voluntary", the charter involuntary liquidation preferences should be treated as the exclusive measure of the preferred stockholders' claims. In so holding the Commission relied on this Court's ruling in *Otis & Co.* v. *S. E. C.*, 323 U. S. 624, at p. 638, "that Congress did not intend that its exercise of power to simplify should mature rights created without regard to the possibility of simplification of system structures which otherwise would arise only by voluntary action of the stockholders, or involuntarily, through action of creditors" (R. 61a). This conclusion was accepted by both courts below (R. 288a, note 2, and R. 34).

Engineers had urged that losses had resulted from previous dispositions of property required by the Act and that the payment of anything in excess of $100 a share to the preferred would for that reason operate as a "windfall" such as the

[9] Commissioner Hanrahan, concurring in the result, expressed the opinion that the liquidation was voluntary and that the voluntary liquidation preferences were dispositive of the issues (R. 140a–141a).

[10] The pertinent authorities are discussed at p. 79, *infra*.

Otis case sought to avoid. The Commission rejected the factual basis for this hypothesis in view, *inter alia*, of the vast improvement in market value and investment position of Engineers common stock since the passage of the Act (R. 72a, n. 55). In fact, independent analysis by members of the investment industry indicated that the common stock would be the chief beneficiary of the dissolution of Engineers and the elimination of the preferred (R. 1990a, 2023a). In any event, the Commission regarded the issue as to losses in prior transactions as irrelevant. It understood the *Otis* case as holding only that the Act was not intended "to mature claims and thereby transform the existing value of a security in a going concern into a matured claim which might be greater or less than such existing value"[11] (R. 72a).

Engineers decided on advice of counsel (R. 1949a) to accept the Commission's findings and amended the plan to provide for the additional payments to the preferred. Two common stockholder groups (both are respondents in Nos. 226, 227, and 243 and one is petitioner in No. 266) then appeared in opposition to the amended plan.

[11] The Commission noted that the precise issue in the *Otis* case was whether preferred stockholders should benefit at the expense of the common stock by treating the liquidation preference as matured, whereas in the instant case the issue was whether common stockholders should receive a windfall by being permitted to retire preferred stock at less than its going concern value (R. 72a).

The amended plan was approved by the Commission as fair and equitable to both the preferred and common stockholders.[12] Upon application for enforcement of the plan, the district court, in the exercise of what it considered to be its "affirmative and independent duty" (R. 286a), found that $100 per share was the fair and equitable equivalent of the claim of each series of preferred stock, and disapproved that portion of the plan calling for a payment of more than $100 per share. This conclusion was reached by the district court despite its acceptance of the Commission's finding that the "present value for these preferreds [is] substantially in excess of the charter liquidating preferences"[13] (R. 290a). The district court rejected the conception that the amount of cash to which the preferred stockholders were entitled should be determined on the basis of a valuation of (or the investment value of) what they surrendered by the plan. Instead it construed the *Otis* case as determining participation in accordance with a standard of

[12] — S. E. C. — (1947), Holding Company Act Release No. 7119 (R. 128a).

[13] Subsequent to its opinion the court adopted certain findings of fact, in the form presented by the common stockholders, which, while not repudiating the acceptance of the expert testimony as to present value, stressed the possibility that through future increase in interest rates, or decline in earnings, or both, the future value of the preferred stock, if allowed to remain outstanding, might well be substantially less than its present value (R. 310a–315a).

"colloquial equity." (R. 291a). Various non-valuation criteria were weighed to determine whether or not they "look toward non-payment of the premium" (R. 289a). The facts cited were (a) the issue price and market history (R. 289a); (b) that past divestments required by the Act occasioned losses and were a hardship on the common stock (R. 290a); (c) that the present high value of the preferred reflects retained earnings representing "past sacrifices" by the common stock (R. 291a). As we note in the argument, some of the factors emphasized by the district judge are relevant to appraising the present value of the preferred and to that extent were considered by the Commission. The district court, however, having agreed with the Commission's findings as to the present value of the preferred on a going concern basis, regarded these factors as significant in determining that it was not fair in a colloquial sense to give the preferred stockholders the full going concern value of the interest which the plan required them to surrender.[14]

[14] The district judge's rejection of a fixed principle of fairness and equity in favor of an undefinable concept of colloquial equity was further elucidated in a subsequent case in which the same court happened to agree with the Commission's finding as to fairness. See *In the Matter of Cities Service Company*, 71 F. Supp. 1003, at pp. 1004, 1005 (D. Del), in which the court below stated:

"* * * the test is not simply whether the senior security holders, in their order of preference, get the equitable equiva-

The court entered an order approving and enforcing the plan except insofar as it contemplated payments of any amount in excess of $100 per share and accrued dividends to the preferred stockholders. It also approved the proposed escrow agreement whereby additional amounts were set aside for preferred stockholders if as a result of an appeal they should be held entitled to the larger amounts which they claimed and which the Commission had approved. (R. 318a.)

On appeal by the Commission and preferred stockholders, the Circuit Court of Appeals for the Third Circuit upheld the district court in its rejection of the Commission's determination that the amended plan was fair and equitable, but held that the district court "cannot value the securities, find equitable equivalents therefor and substitute its own estimates for those of the Commission" (R. 39). The decree of the district court was accordingly vacated and the case was remanded to the Commission for a fresh determination of the amount which the preferred

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lent of the rights surrendered as they would in a reorganization case where insolvency obtains, i. e., the test exemplified by *Group of Institutional Investors, et al.* v. *Chicago, Milwaukee, St. Paul & Pacific R. R. Co.*, 318 U. S. 523, * * * but whether all classes of stockholders are getting fair and equitable treatment based on notions of colloquial equity.

* * * * * *

"* * * I wish to re-emphasize that once the charter provision [on liquidation] is regarded as not controlling, the relative rights of the various security holders are determined by the application of standards of colloquial equity."

stockholders should receive. The court neither expressly approved nor disapproved the conception of the district judge that "colloquial equities" rather than strict priorities should govern in Section 11 (e) reorganizations. It did, however, indicate that it was proper for the district judge in the exercise of his independent judgment to weigh as reasons for rejecting a plan approved by the Commission the various elements which the district judge had characterized as "colloquial equities." Apparently, the Commission on remand would be required in some fashion to appraise these "equities."

All appellants filed petitions for rehearing and in the Commission's case for clarification as well, which were denied. All appellees filed cross-petitions for rehearing, directed to the holding that the case should be remanded to the Commission. These petitions were also denied.

SUMMARY OF ARGUMENT

I

The Commission properly accorded Engineers preferred stockholders the going concern value of their interests. It is not disputed that the Commisson properly approved a type of plan under which the preferred stockholders surrendered their investment for cash, and the common stockholders received the entire residual assets. Both courts below agreed with the Commission that under *Otis & Co.* v. *S. E. C.*, 323 U. S. 624, the

involuntary liquidation preferences of $100 per share were not determinative of the preferred stockholders' claims, and both courts below likewise upheld the Commisson's determination that the value of the preferred stocks on a going concern basis was at least equal to the amount of the redemption prices.

The *Otis* case holds that the principle of strict priority applies under Section 11 (e) in determining the rights of stockholders of a solvent company, and that the preferred stockholders are entitled to the going concern value of their stock. Full compensation must be given for the entire "bundle" of rights surrendered, including the preferential dividend claims as well as the liquidation preferences. Under the principle of the *Otis* case the preferred is entitled to this going concern value whether it is more or less than the amount to be received on liquidation. The holdings of the courts below are contrary to the rule of full priority insofar as they permit diminution of what the preferred stockholders would otherwise receive by reason of "colloquial" or "special" equities which relate neither to the appraisal of the financial value of the interests surrendered, nor to the imposition of sanctions for inequitable conduct.

The Commission's findings of present value, which the courts below accepted, took into account the risk that the future value of the preferred stock, if it remained outstanding, might be less

than its value as of the time when the preferred stockholders were required by the plan to surrender their investment. This appraisal of the risk factor, which was conceded by the Engineers management, necessarily took into account the future earning power of Engineers although it did not require a precise forecast of the extent that future earnings might exceed what was necessary to maintain preferred stock dividends.

According the preferred stockholders no more and no less than their full priority rights and giving everything else to the common stockholders was necessarily fair to the common. In any event, it appeared that the common were benefited by the plan, and to have reduced to a dollar valuation what the common received and surrendered by the plan would have complicated the appraisal of fairness without affording any useful check upon the results reached by the simpler process of focusing attention upon the proper amount of cash payable to the preferred. Contrary to the holding of the Court of Appeals, this method of valuation involved the consideration by a similar standard of the interests of both preferred and common stockholders. It did not involve valuing either the preferred or the common "as if the Act had never been passed." Instead, as in the *Otis* case, the method which the Commission used was that of "giving value to the rights of the preferred in a going concern rather than as if by sale and distribution." *Otis & Co.* v. *S. E. C.*, 323 U. S. 624, 635.

The requirement of the court below that the Commission reconstitute the balance sheet of Engineers as it would have been if the Act had never been passed is administratively impracticable and could not affect the result unless, contrary to the rule of strict priorities, the risk of loss in prior transactions is to be shifted from junior to senior security holders. Other colloquial equities such as the issue price and past market history and the dividend history of Engineers are likewise irrelevant to the fair and equitable standard, and insofar as pertinent to the valuation of the preferred on a going concern basis were adequately reflected in the valuations which the courts below accepted.

II

The Commission and the courts below properly followed the *Otis* case in holding that the liquidation preferences of the preferred are not the controlling measure of their rights of participation. The decision in the *Otis* case upholding the Commission's valuation of the preferred stock on a going concern basis rests on the conclusion that Congress did not intend Section 11 plans to accelerate maturities and thereby shift values from one class of security holders to another. It does not rest upon the particular form which the liquidation takes, nor upon whether the holding company being liquidated is a top holding company whose assets consist of stock in an-

other holding company which survives the plan, or a holding company in the first degree, the assets of which consist of operating company common stocks.

III

The scope of judicial review applicable in this case depends we believe, not upon differences between the review function of a court of appeals under Section 24 (a) and a district court under Section 11 (e), but upon the nature of the administrative determination upon review. The question here does not relate to the evidentiary foundation for the Commission's decision, assuming that it followed a proper method of valuation. Whether or not it followed a proper method presents the question of law which we think is the issue in this case.

If, as the court below seemed to assume, the question is not one of law, we submit that the scope of review under Section 11 (e) is limited in the same manner as that applicable to determinations of the Interstate Commerce Commission under Section 77 of the Bankruptcy Act, which embodies a similar statutory scheme. Under this standard administrative determinations of value are sustained if supported by substantial evidence, *Ecker* v. *Western Pacific R. Corp.*, 318 U. S. 448, 473; *R. F. C.* v. *Denver & R. G. W. R. Co.*, 328 U. S. 495, 505–509. The court's responsibility for the exercise of independent judgment concerning the plan is a review func-

tion limited primarily, though not entirely, to issues of law. On any theory of review, the court's function does not extend to rejection of policy determinations which are not arbitrary and are within the area of discretion delegated to the agency by the statute.

To whatever extent the review function of the Section 11 (e) court may extend beyond issues of law, its determinations as to what is fair and equitable should be controlling upon the Commission upon remand lest stalemates result from conscientious disagreement between court and agency. Such determinations of the court should likewise be open to full examination on appeal so that there may be uniform nation-wide administration of the fair and equitable standard rather than making allocations dependent upon accidents of venue.

ARGUMENT

I

THE COMMISSION PROPERLY INTERPRETED AND APPLIED THE FAIR AND EQUITABLE STANDARD OF SECTION 11 (e) IN THE LIGHT OF THE UNDISPUTED FACTS

A. *The Otis case upholds the Commission in applying the doctrine of full priority by valuing preferred stock on a going-concern basis*

There was, and is, no dispute that the Commission properly approved as "appropriate to effectuate the provisions of" Section 11 (b) a type of plan under which the preferred stockholders were to be paid in cash whatever amount might be

found fair and equitable and the entire residual assets were made available to the common stockholders.[15] This type of plan was the choice of Engineers' management, elected exclusively by common stockholders. The management regarded this type of plan rather than an allocation plan as advantageous from the point of view of the common stockholders (R. 719a, 723a, 807a). Thus, the basic issue of fairness which the plan tendered to the Commission was how much cash would constitute fair compensation to the preferred stockholders for the compulsory surrender of their investment. The Commission concluded that, under the doctrine of strict priorities, it was fair for the preferred stockholders to receive, and the common stockholders to pay, the undisputed value of that investment, computed on a going concern basis and in relation to the then current yield on investments of comparable risk.

[15] The cash which the plan made available was in part cash already on hand, and in part the proceeds derived from the sale of Engineers' holding in Gulf States Utilities Company pursuant to subscription warrants issued under the plan to Engineers' common stockholders. The subscription warrants were transferable and, since the market price of the stock was higher than the exercise price in the warrants they could be sold by stockholders who might not elect to pay the subscription price. To the extent of such sales it was, of course, the transferees of Engineers' common stockholders who received the Gulf stock free of the preferred stockholders' claim. Common stockholders who sold their warrants and did not contribute cash received in any event common stock of Virginia and El Paso plus the proceeds of the sale of their subscription warrants.

The district court, in applying what it described as standards of "colloquial equity" to determine the amount of cash which would fairly compensate the preferred for the surrender of their rights, apparently did not regard the doctrine of strict priorities as applicable. The Court of Appeals did not use the phrase "colloquial equities" except in summarizing the opinion of the district court. It did refer to the necessity that the Commission consider "all the pertinent factors" (R. 37, 38), and the context indicates that the Court of Appeals considered as pertinent what the district court weighed as "colloquial equities." Since the valuation standards which the opinion of the Court of Appeals imposes on the Commission appear to us also to be in contravention of the principle of strict priorities, we point out at the outset that this Court has unanimously held the doctrine applicable under the Holding Company Act to the reorganization of solvent companies and as between different classes of stockholders. The majority opinion in *Otis & Co.* v. *S. E. C.* 323 U. S. 624, 634, states:

> Like the bankruptcy and reorganization statutes, the Public Utility Holding Company Act, in providing that plans for simplification be "fair and equitable," incorporates the principle of full priority in the treatment to be accorded various classes of security interests. This right to priority in assets which exists between creditors and

> stockholders, exists also between various classes of stockholders.

See also n. 14, p. 634. The dissenting opinion was, if anything, even more emphatic in its assertion that the principle of strict priority applies in Section 11 (e) reorganizations of solvent companies (323 U. S. 624, at 647–648).

The point of difference between the majority and dissenting opinions in the *Otis* case was whether the charter liquidation preference was the measure of the preferred stockholders' rights to which priority should be accorded or whether, as the majority put it, the Commission properly "recognizes and applies the doctrine of full priority by giving value to the rights of the preferred in a going concern rather than as if by sale and distribution" (p. 635). In upholding the Commission as to that issue the majority opinion states (p. 638):

> * * * Congress did not intend that its exercise of power to simplify should mature rights, created without regard to the possibility of simplification of system structure, which otherwise would only arise by voluntary action of stockholders or, involuntarily, through action of creditors.

For that reason this Court concluded that the Commission "applied the correct rule of law as to the rights of the stockholders *inter sese*" in that "the rights of stockholders of a solvent

company which is ordered * * * to distribute its assets among its stockholders may be evaluated on the basis of a going business and not as though a liquidation were taking place" (p. 633).

In the *Otis* case the claim of the preferred stockholders, if measured by the charter liquidation preference, would have been greater than its existing value as an interest in a going business. The Commission considered the same principle applicable in the *Engineers* case where, in contrast to *Otis,* the involuntary liquidation value of the preferred stock was less than the undisputed value of its claim as an interest in a going business (as limited by the call price). In other words, the Commission construed the *Otis* case as meaning that Section 11 (e) reorganizations of solvent companies should not mature otherwise inchoate stockholders' liquidation preferences whether the amount of such liquidation preferences might be greater or less than going concern values (R. 72a). Both courts below upheld the Commission's interpretation of the *Otis* case as not making Engineers' involuntary liquidation preference "dispositive" (R. 288a, n. 2, and R. 34).[16] Engineers' common

[16] Since the decision of the court below this Court has had occasion to restate its holding in the *Otis* case as follows (*Schwabacher* v. *United States*, 334 U. S. 182, 199):

"In construing the words 'fair and equitable' in a federal statute of very similar purposes, we have held that although the full priority rule applies in liquidation of a solvent holding company pursuant to a federal statute, the priority is

stockholders still dispute the correctness of this holding, and urge grounds for distinguishing the *Otis* case which the courts below rejected. Nevertheless, in arguing that the courts below erred in their disposition of the valuation issues, we start with the assumption that they properly held the liquidation preferences not dispositive. In Point II, *infra*, pp. 75–84, we answer the common stockholders' contention that the courts below erred in so holding.

Once it is settled that the involuntary liquidation preference is but one factor in valuation, rather than the controlling measure of what Engineers' preferred stockholders are entitled to receive in the reorganization, and that the plan properly provided for a cash settlement with preferred stockholders, we believe it necessarily follows under the doctrine of strict priority that the amount of cash which the preferred stockholders should receive should be equal to the undisputed "present value or investment worth * * * on a going concern basis" or the "in-

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satisfied by giving each class the full economic equivalent of what they presently hold, and that, as a matter of federal law, liquidation preferences provided by the charter do not apply. We said that, although the company was in fact being liquidated in compliance with an administrative order, the rights of the stockholders could be valued 'on the basis of a going business and not as though a liquidation were taking place.' Consequently the liquidation preferences were only one factor in valuation rather than determinative of amounts payable."

vestment values" of the preferred. If this is the correct rule of law, the Commission's valuation finds clear support in the evidence and indeed rests upon undisputed evidence.[17] We discuss below the various grounds upon which the common stockholders and the opinion below reject the Commission's ultimate conclusion that it was fair to give the preferred stockholder the current going concern value of their investment.

B. *The principle of strict priority applies to the entire bundle of preferred stockholders' rights, including going-concern values in excess of involuntary liquidation preferences*

This Court has held that the principle of strict priority requires full compensation for the entire "bundle of rights" surrendered. *Consolidated Rock Products Co.* v. *DuBois*, 312 U. S. 510, 528; *Group of Investors* v. *Milwaukee R. Co.*, 318 U. S. 523, 556. Similarly, the *Otis* case expresses the requirement for "full compensatory treatment," as an alternative expression for the requirement that " 'each' security holder in the order of his priority [shall receive] from that which is avail-

[17] Engineers' counsel themselves conceded this, both in argument before the Commission and in an opinion rendered the directors in connection with Engineers' decision to amend the plan to accept the Commission's view as to what fairness required (R. 67a, 1211a, 1953a). As we show below, the common stockholders' challenge to this valuation is, insofar as it relates to value as of the effective date of the plan, wholly unsupported in fact and basically involves a contention that it was not fair to value the preferred stockholders' claims as of the time they were compelled to surrender them.

able for the satisfaction of his claim the equitable equivalent of the rights surrendered.'" 323 U. S. at 639–640. See also *Ecker* v. *Western Pacific R. Corp.*, 318 U. S. 448.

Counsel for the common stockholders have attempted to reconcile the decision below with the doctrine of strict priorities by arguing that the involuntary liquidation preference is the measure of the preferred stockholders' claim. See Point II, *infra*. Even where they purport to assume *arguendo* the correctness of the holdings below that under the *Otis* case the involuntary liquidation preference is not dispositive, they insist upon treating any claim on the part of the preferred stockholders to be compensated for loss of values in excess of $100 a share as a right of an ephemeral character not entitled to strict priority, but only to such limited recognition as may commend itself to the discretion of the court. This amounts to arguing that preferred stockholders are entitled to strict priority for their liquidation preference but not to receive the equitable equivalent of their dividend preference. But clearly the dividend preference is as much a part of the contract as the liquidation preference.[18]

[18] However, see Central Illinois' answer to petition for rehearing in the court below (R. 103), which states in part:

"It does not lie in the power of an administrative agency or even of a court of equity to enlarge the *preferential* claim of senior security holders, because such preference is purely a creature of contract. If in a liquidation or reorganization equitable considerations are found to warrant payment to

Common stockholders in the court below compared the preferred stockholders' claim to full compensatory treatment for their right to "excessive dividends" with the claim for interest on interest on corporate debt disallowed by this Court in *Vanston Bondholders Protective Committee* v. *Green*, 329 U. S. 156. We believe there is an obvious distinction, however, between refusing to allow interest on the unpaid interest which is accumulated during judicial administration, and refusing to allow preferred stockholders compensation for deprivation of future dividend claims at rates slightly higher than the going rate for investments of comparable risk. One of the evils of holding company preferred stocks was that their characterization as "preferred" tended to deceive the preferred stock investor by obscuring the extent of the risk factor resulting from the holding company preferred being junior to the operating company preferred stocks as well as to the bonds of the system. The past market history of Engineers' preferreds and the interruption of dividends during depression years illustrates the fact that the original preferred investment involved substantial risk. The fact that the

senior security holders of amounts in excess of the preferential claim established by the charter, such additional amounts do not form part of the *preferential* claim of the senior security holders but merely constitute a supplemental claim which must be balanced against corresponding equitable considerations in favor of the junior security holders." (See also the footnote to the above statement.)

dividend rates on Engineers' preferred stocks can now be characterized as "excessive", reflects improvement in Engineers' financial condition and lowered money rates from which Engineers common stockholders, on any theory, receive the major benefit.[29]

It should be noted that disallowance of interest on interest is a doctrine designed to prevent the misfortune of junior interests from operating to enrich senior security-holders. But allowing preferred stockholders compensation for being deprived of future dividend claims in amounts above the going rate in relation to risk is merely in recognition of a basic implication of the contract that (subject to the redemption price ceiling) the preferred stockholders are to share prosperity, to the extent of their limited dividend, in return for running risks which all too often approach that of common stockholders.

The common stockholders have also urged that recognition of going concern values which exceed involuntary liquidation preferences is unsound

[29] Engineers was benefited by cheap money in refunding operating company preferreds at lower rates. In addition, the value of the operating company common stocks which the plan makes available to Engineers common stockholders reflects the prospective yield on those common stocks, which, as qualified by the risk factor, must be evaluated in relation to the current cost of money. Because of the redemption price ceilings Engineers preferred will, even under the plan as approved by the Commission, obtain only a portion of the value otherwise added by cheap money to their dividend claims.

because recognition of the full going concern value of a high grade non-callable preferred would result in "leaving little or nothing for junior securities possessed of substantial value on the basis of every recognized criterion of reorganization law" (R. 104). This argument ignores the obvious fact that preferred stocks only become "high grade" so as to be valued in the market at rates approaching the yields for high grade bonds when their margin of security, both asset wise and earnings wise, is so substantial as to indicate that a great deal would remain for the common after full satisfaction of the prior rights of the preferred.[20]

Similarly, the district court in its appraisal of colloquial equities drew a distinction between the preferred stockholders receiving back their, or their predecessors', original investment, which approximated the involuntary liquidation pref-

[20] The only actual cases in which the Commission has had occasion to deal with non-callable preferred stocks under Section 11 (e) plans have been cases where, unlike Engineers, the charter limited the preferred to the same amount on voluntary liquidation as on involuntary liquidation. The Commission's valuation took into account the possibility that, apart from Section 11, the enterprise would have been liquidated, voluntarily or involuntarily. See *In the Matter of American Light and Traction Co., et al.*, Holding Company Act Release No. 7951, affirmed on a review petition which did not raise the issue of allocation, November 3, 1948 (C. C. A. 8); *In the Matter of Public Service Co. of N. J.*, Holding Company Act Release No. 8002, approved and enforced, United States District Court for the District of New Jersey, Civil Action No. 11,105 (1948).

rence of $100 a share, and receiving compensation for "the theoretical future deprivation of their present excessive [sic] dividend rate" (R. 291a). Consistent with this approach the district judge "valued" the $5, the $5.50 and the $6 preferred alike, according to each series $100 per share. The Commission's valuation, on the other hand, reflected the differences in the dividend rates on each series of preferred except as the redemption prices imposed ceilings.

The opinion of the Court of Appeals is less clear in distinguishing between the priority to be accorded dividend preferences and the priority to be accorded liquidation preferences.[21] That opinion holds "that investment value is and can be only *one* of a series of factors to be used in arriving at equitable equivalents"; and that "the new doctrine of investment value presently urged by the Commission may not be substituted for the doctrine of equitable equivalents enunciated in the Otis & Co. decision" (R. 38). The Court of Appeals also paraphrased the principle of equitable equivalence as one of "just recompense" rather than "full compensatory treatment", indicating that its requirement is not satisfied by a mere financial appraisal. This appears to be in

[21] The Court of Appeals in according the Commission latitude to value either "ex the Act" or "intra the Act", apparently leaves it free to take into account differences of dividend rates if it does value "ex the Act," but couples this with the requirement that the Commission add back losses

line with its upholding the discretion of the district court in the weighing of special or colloquial equities, since none of the special equities adverted to have any relation to the imposition of sanctions for inequitable conduct in connection with the acquisition of claims.[22]

The allowance for such equities by the courts below appears to us to permit that which this Court has repeatedly condemned in the decisions which state the rule of strict priority, namely, the subordination of prior rights for the benefit of junior interests. As this Court has stated "Unless that principle [of priority] is respected, * * * the property of one group will be subtly appropriated to pay the claims of another while lip service is rendered the principles of priority." *Group of Investors* v. *Milwaukee R. Co.*, 318 U. S. 523, 570.

[22] Since the preferred stockholders did not elect the management of Engineers, and indeed had no voting rights at all, there was and could be no suggestion that inequitable conduct on their part warranted special treatment amounting to less than full recognition of their claim. As we show below, none of the "colloquial" or "special" equities emphasized by the courts below had any relation to the equities which have been held to warrant disallowance, subordination or limitation to cost in such cases as *Taylor* v. *Standard Gas and Electric Co.*, 306 U. S. 307; *Pepper* v. *Litton*, 308 U. S. 295, 307; *S. E. C.* v. *Chenery Corp.*, 332 U. S. 194.

C. *Contrary to the holding of the Court of Appeals the Commission's valuation of Engineers' preferred stock gave adequate consideration to the future earning power of Engineers*

The opinion of the Court of Appeals criticizes the Commission's method of valuation because as the court stated (R. 35):

> But we think it is clear that it [the Commission] did not give any substantial consideration to the future earning power of Engineers and its subsidiaries which the Supreme Court has held is one of the fundamental tests for reorganization valuation. See *Consolidated Rock Products Co.* v. *DuBois*, 312 U. S. 510, 526, and *Group of Investors* v. *Milwaukee R. Co.*, 318 U. S. 523, 565–6. In the instant case the Commission made no attempt to ascertain the future earning power of the system nor to apportion earning power between the preferreds and common based on their respective claims to income as it did in The United Light & Power Company case. But if values for the securities are to be determined *ex* the Act it is clear that the Commission should have done so.

The United Light & Power plan (which was involved in the *Otis* case) was a plan to use a single medium of payment, common stock of

Power's sole subsidiary, to compensate both preferred and common stockholders of Power for the surrender of their respective claims against Power. The apportionment of that stock necessarily involved evaluation of the expectation of income (together with the risk factor) from the new security in relation to what each class of security holders received and surrendered. The Engineers plan, however, did not permit any apportionment of earning power to the preferred stock,[23] but settled with the preferred in cash and reserved the earnings assets for the common.

The "earning power" of the cash received could be appraised only in relation to the reinvestment opportunities open to the preferred. They were, of course, free to choose an investment which might yield less but be more secure than what they gave up, or a more risky investment which might promise a higher yield. But the most workable hypothesis for finding a fair equivalent between cash received and the security surrendered under the compulsion of the plan, is that of reinvestment in a security of comparable risk. How much money would it cost the preferred stock-

[23] Some of the earnings assets, *i. e.*, the Gulf States stock, were distributed pursuant to a warrant program under which the common stockholders could either sell their warrants and realize some cash from the distribution or exercise their warrants and receive Gulf States stock upon the payment of $11.50 per share. This distribution was analyzed by the Commission and it was found that the additional investment, if made, would entitle the common stockholder to additional earnings on a pro forma basis of $1.04 per share (R. 71a).

holders to replace their securities with comparable ones? This equation was substantially the basis upon which the valuation witnesses testified as to what a willing buyer and a willing seller would give for Engineers preferred stocks apart from Section 11.

Both Badger and Barnes agreed that on a going concern basis and ex Section 11 a "willing buyer and * * * a willing seller" would so appraise the risk factor of Engineers preferred in relation to its dividend rate, that they would be willing to pay slightly in excess of the redemption prices (R. 522a, 658a–663a). Badger reached his result by comparison of current yields of other similar preferred stocks. He concluded that a proper yield basis for the Engineers preferred was 4.6%. This yield basis represented his estimate of how the investment markets would evaluate the risk of Engineers stockholders not receiving their preferential dividends in perpetuity, disregarding both the impact of Section 11 and the redemption price ceilings. This 4.6% yield basis, or capitalization rate, resulted, as a matter of mathematical computation, in values ranging from $108.70 per share for the $5 preferred to $130.33 per share for the $6 preferred.

In appraising what the preferred stockholders surrendered through the plan, the Commission was dealing with a limited, although prior, claim on earnings and the focus of the Commission's inquiry was, therefore, not the total amount of

Engineers' prospective earnings but the degree of risk that future earnings would be sufficient to maintain the preferred dividend. The Commission, in addition to considering the expert valuation testimony, made its own analysis of the financial data in the record, including the historical earnings record of the holding company system, and the coverage for the preferred dividends. (See especially R. 63a–65a and 86a–101a.) It appeared, for example, that the preferred dividends were covered by earnings 1.6 times on a consolidated basis and 2 times on a corporate basis according to the most recently available 12 months figures (R. 64a–65a). These were among the factors Badger had relied on in his testimony that the risk factor on the preferred was low enough to warrant it selling on a going concern basis (and disregarding the redemption prices) at values ranging from $108.70 per share for the $5 preferred to $130.33 per share for the $6 preferred. The Commission recognized, however, that the common stockholders were free to exercise the redemption privilege as a means of retiring the preferred stock without reference to the reorganization provisions of Section 11, and therefore treated the redemption prices as a ceiling. In view of this holding, it was only necessary for it to find, as the Engineers' management conceded, that the going concern value of the preferreds was at least equal to the

redemption prices[24] (R. 522a, 658a–663a). For the Commission to have attempted a precise forecast of Engineers' future earnings would have in no way advanced its valuation process.

The Court of Appeals noted, apparently without disapproval, that "the District Court expressly stated that it accepted Dr. Badger's values and that in the absence of a showing of changed circumstances it would deem them to be applicable at the time of the hearing" (R. 17). At another point, however, it is stated: "The trial judge also made a cogent finding respecting Dr. Badger's use of interest rates as an aid in fixing values for the preferred deeming the interest rate used by the latter to be too low" (R. 19).[25] Reference is then

[24] Allowing the preferred stockholders the redemption prices of $105 for the $5 and $110 for the $5.50 preferred and $6 preferred involved, as a matter of mathematical computation, allowing to their dividend claims in perpetuity capitalization rates of 4.76%, 5% and 5.45%, respectively. The difference between the lowest of these rates and the 4.6% figure arrived at by Badger illustrates the margin between the Commission's valuation and the Badger testimony accepted by the district court.

[25] The district court did not make any finding that the interest rate used by Dr. Badger was too low by then prevailing standards of the markets. Instead it adverted to a rise in interest rates since the Badger testimony and concluded that (Finding No. 52, R. 314a):

"A continuance for two or three years of the trend indicated over the past year could substantially reduce or wholly eliminate the differential in the current yield rate over dividend rate in the case of preferred stocks of the type of Engineers."

Because of the risk of future adverse changes in interest rates the district court concluded that the current values as

made to one of the court's findings "of fact" to the effect that "the extremely low money rates which resulted in Badger's finding that the preferred stocks of Engineers have an 'investment value' greater than $100 per share, largely reflect artificial factors which are clearly subject to changes at any time and may well be of purely transitory character." (See Finding No. 51, R. 313a–314a quoted in full at R. 19–20, n. 9.)

The possibility of change in interest rates, like the risk that earnings might decline for a variety of causes, was clearly a risk common to the comparable investments with which Engineers preferred stock was compared, and could apply also to any investment the preferred stockholders might make with the cash which they received under the plan.[26] There is no suggestion

found by Badger "are by no means determinative of the investment value of these stocks for any considerable period of time in the future." (Finding No. 54, R. 315a.)

[26] Barnes mentioned five factors which might adversely affect the future price level of the preferreds if they remained outstanding: (1) continued inflation, (2) periodic depressions, (3) possibilities of government competition, (4) adverse changes in the policy of regulatory authorities, and (5) nuclear energy. He did not, however, claim that any of these risks affected the present value of the Engineers preferred, conceding (R. 522a, 525a):

"These adverse factors which I have just referred to are common to the utility industry generally and are no more imminent in the areas served by our subsidiaries than they are generally throughout the country so that present price levels of securities reflect the extent to which the investing public is presently appraising these hazards, but to say that

in the opinions below that the probability of an increase in the cost of money was sufficiently great to warrant the preferred stockholders in maintaining the cash received from the Engineers plan intact to await a more favorable reinvestment opportunity in the future, or that investment yields were likely to rise sufficiently rapidly to compensate for the loss of any interest at all while waiting for an expected drop in the market price of comparable investments. We believe it utterly unrealistic to assume that the average investor would have sufficient percipience to follow such a course ever if it were the subject of accurate forecast by experts.

If it were the preferred stockholders who were insisting upon being paid off in cash, rather than receiving an allocation of operating company common stocks, which would give them, in compensation for the surrender of their prior position, an opportunity to share in earnings beyond their existing preferences, there would be more color of fairness in insisting that the preferred stockholders' participation be related to necessarily fallible estimates as to the future earnings. Even in that event we believe the standard of fairness requires the application of realistic discount factors which compensate for the element of uncertainty in the forecasting process. Here, however, it was the common stockholders' choice

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these prices reflect reasonably foreseeable future values is obviously not correct as only the future can disclose what these later values may be."

to retire the preferred in cash and the timing was also to a large extent the common stockholders' choice. Under the circumstances, the Commission was, we submit, fully warranted in valuing the preferred in accordance with its cash value as of the date of its determination rather than speculating as to its possible future value.[27]

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[27] While the district court took official notice that interest rates had changed slightly since the testimony was taken before the Commission he did not find sufficient change to warrant on that ground a rejection of the Commissoin's valuation. The district court and the court below merely referred to interest changes as illustrating the possibility of future interest changes. In the cross petition and in the brief in opposition counsel for Central Illinois adverted to changes in interest rates since the decision of the district court. However, inasmuch as the plan had been consummated shortly after the decision below, and the preferred stockholders were then required to surrender their investment for cash, we believe that any later changes in interest rates would be wholly irrelevant. In any event, such changes in interest rates as have occurred have not been sufficient to render obsolete the Badger valuation testimony, accepted by the district court, in view of the ample margin between the Badger going concern values and the redemption price ceilings fixed by the Commission. Our own computation, based upon market prices on December 14, 1948, shows an average yield at the present time of 4.87 per cent for the securities now outstanding used by Badger as the basis for his comparisons. This calculation was made as follows:

Security	*Price*	*Yield*
Bangor Hydro Electric	150.00	4.67
California Oregon Power	109.00	5.50
Central Illinois Light	104.00	4.33
Consumers Power	103.50	4.35
Georgia Power	104.75	4.77
Kansas Power & Light	103.00	4.37
New Orleans Public Service	98.25	4.83

D. *The Commission's finding that the plan accorded preferred stockholders no more and no less than fair compensation for the surrender of their prior claim, and that it was beneficial to the common to retire that prior claim in cash, was adequate support for its conclusion that the plan was fair to common stockholders*

The Court of Appeals likewise criticized the Commission because it "made no finding as to the 'value' of the common stock" (R. 35). Here again we believe the court below misconceived the nature of the valuation problem presented by the plan.

Since the common stockholders received everything that remained after satisfying the preferred stockholders' prior claim, the Commission merely applied the Euclidian axiom that the sum of the parts equals the whole when it concluded that it was necessarily fair to the common to recognize "the full priority of the preferred stockholders as required by the statute" (R. 73a).

The district court stated (R. 291a):

> The argument for payment of the premium is comparable to dealing cards off the top of a deck. When full hands (based on theoretical "investment value") have been dealt to all the senior security holders, the

Security	Price	Yield
Niagara Hudson Power	97.25	5.14
Pacific Public Service	23.50	5.53
Pennsylvania Power & Light	101.25	4.44
West Penn Electric	105.50	5.69

> common would merely get whatever happens to remain. Under the Act the interest of all investors must be considered.

The Commission, of course, agrees that the interest of all investors must be considered in applying the fair and equitable standard but, as this Court has repeatedly held, they must be considered in the strict order of their priorities, which means that the common gets what is left after the preferred gets the value of its share. There thus is no point to attempting to ascertain the separate value of the common.

It may be urged that the above quoted statement by the district court, and the Court of Appeals' insistence that the Commission make a "finding as to the 'value' of the common stock", reflect merely belief that valuing what the common stock received and surrendered through the plan would afford a necessary check upon the Commission's determination of the investment value of the preferred. With the investment value of the preferred undisputed, however, and expressly accepted by the District Court, we are unable to reconcile such a requirement for duplicate valuation with the holding of the Court of Appeals that "the selection of possible though varying techniques [of valuation] is for the Commission in the exercise of its expert administrative judgment" (R. 37).[28] In any event placing a dollar value

[28] The Commission had checked the fairness of the treatment accorded the preferred by finding that the common

upon what the common stock received and surrendered through the plan could not serve as a check upon the Commission's conclusion as to the amount of cash which it was fair for the preferred stockholders to receive and for common stockholders to pay under the plan. Such a valuation would have involved a process far more speculative than the determinations already made by the Commission[28] and this would be of no value as a check.[29]

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stockholders were benefited by retiring the preferred at the redemption prices, and this also was undisputed.

[28] Although for purposes of establishing fixed charges and making valuations Subsections 77 (b) (4) and 77 (e) of the Bankruptcy Act, 11 U. S. C. 205 (b) (4) and (e), expressly direct the Interstate Commerce Commission to give due consideration to past, present, and *prospective* earnings, it seems clear that both the Commission and the courts have not deemed it essential that the Commission attempt to make precise forecasts of future earnings as distinguished from forecasting that future earnings will be sufficient to support the new capital structure which the plan provides, or determining that in the light of earnings records plus opinion evidence as to prospective earnings, the new securities allocated to each class are the equitable equivalent of the interests surrendered. See *Western Pacific R. R. Co. Reorganization*, 230 I. C. C. 61, 233, I. C. C. 409, *affirmed sub nom. Ecker* v. *Western Pacific R. Corp.*, 318 U. S. 448; *In re Erie R. Co.*, 37 F. Supp. 237, 245 (N. D. Ohio); Note, 51 Yale L. J. 967, 978. The Securities and Exchange Commission has on occasion used as a working hypothesis what it has described as "earnings forecasts." In so doing the Commission has, of course, recognized the limitations upon human foresight and has applied discount factors which recognize the risk that actual earnings may fall short of the "forecast".

[29] It was a drawback, although we believe an unavoidable one, of the valuation technique employed in the *Otis* case that

E. *The Court of Appeals erred in its criticism of the Commission for allegedly valuing "the preferred ex the Public Utility Holding Company Act, i. e., as if the Act had never been passed" but omitting "consideration of the common by a similar standard".*

The opinion below states: "What the Commission has done is to consider the investment values of the preferred *ex* the Public Utility Holding Company Act, i. e., as if the Act had never been passed. But it considered only the preferreds on this basis" (R. 35). We noted in the previous section of this brief that giving the preferred stockholders the value of their prior claim as computed by the Commission and giving the common stockholders the full residual value of the enterprise necessarily involved consideration of both interests by a similar standard. In this section we show:

(1) the Commission did not value either com-

it did require the Commission to appraise the relative treatment of the United Light and Power Company preferred and common stockholders in the light of forecasts of future earnings. The dissenting Commissioner and dissenting Justices relied in part upon the necessarily attenuated character of that valuation process in arguing that the principle of strict priorities required a denial of any participation to the common stock. The majority of the Commission and of this Court, however, concluded that the difficulties of the valuation process did not warrant denial of participation to a common stock which, as a matter of judgment had a legitimate investment value. See 323 U. S. at 632.

mon or preferred stock "as if the Act had never been passed", but merely valued them on a going concern basis, i. e. apart from the reorganization required by Section 11 of the Act;

(2) there is no warrant for *a priori* assumptions, as a matter of judicial notice, that the overall impact of the Act has been to cause losses to Engineers as an accounting entity, or to its common stockholders;

(3) it would be utterly impractical to require the Commission to reconstitute the history of Engineers since the Act with a view to restoring to its balance sheet any ascertainable excess of losses over gains;

(4) if practical, such a process would involve collateral attack on past transactions which the Act intended should be no longer open to reexamination, and in any event could only strengthen the claim of the preferred stockholders, unless contrary to the rule of strict priorities the risk of losses is to be shifted from junior to senior security holders.

(1) The court's concept of valuation as if the Act had never been passed

The court below noted that "the reasoning which moved the Commission is not as plain as it might be" (R. 35). Apparently what misled the court below was merely that the Commission did not rearticulate the reasons it gave and which this Court approved in the *Otis* case, for valuing

the preferred stocks without treating their liquidation preferences as having been matured by the reorganization process. As was explained to the court below in the Commission's petition for rehearing, the shorthand expressions "apart from the Act" or "ex the Act" must be read with the interpolation, "ex [the present reorganization required by Section 11 (b) of] the Act." [31]

The Commission makes two references to the concept in its opinion. The first is by way of quotation from Engineers' administrative brief upon which the Commission relied for its concessions concerning the value of preferred. Engineers agreed that amounts slightly higher than the voluntary liquidation preferences and the redemption prices "are substantially the present value or investment worth of these three series of stock, on a going concern basis and apart from the Act, under prevailing yields applied to comparable securities" (R. 67a). The Commission also states as its reason for treating the redemption prices as imposing ceilings on the preferred stockholders' claims and thus precluding the preferred from receiving their full going concern

[31] This meaning was urged upon the court below in the petition for rehearing, which was the Commission's first occasion to address itself to what it believed was a misunderstanding by that court of its valuation technique (R. 45–50). The Badger valuation which the courts below accepted was expressly explained in Badger's report as "predicated upon the assumption that Engineers Public Service Company shall continue in operation as presently constituted." (R. 2092a. See also R. 1035a–1036a.)

values, that the redemption price "provides a means, apart from the Act, whereby the security can be retired at a maximum price" (R. 67a). Both of these statements involved dealing with Engineers' assets and liabilities as they actually exist as of the date of the plan rather than as they might have been if the Act had never been passed. In determining, however, the equitable equivalence between the rights accorded by the plan and the rights surrendered, the statutory necessity for a reorganization was not permitted by the Commission to affect the valuation of the rights surrendered, as they would have existed apart from the plan. Instead the old securities were valued (in relation to the new) "as though in a continuing enterprise." *The United Light and Power Co., et al.*, 13 S. E. C. 1, 9. Thus, in both the *Engineers* case and the *United Light* case the interest surrendered by the plan was treated, not as a matured claim to a fixed amount of cash, but as an interest in a going business with the possibility, apart from the reorganization required by Section 11, of becoming a matured claim through involuntary liquidation (a remote possibility), voluntary liquidation or redemption. Under either of the latter possibilities the preferred stock of Engineers would have received the amounts provided under the plan as approved by the Commission.

This use of the "*ex* the Act" concept, as a means of equating rights surrendered and rights

received, occurs repeatedly in the Commission's *United Light* opinion and in this Court's opinion in the *Otis* case. Thus, the Commission noted that in bankruptcy or equity reorganizations, where creditors and other claimants are prevented from foreclosing or compelling an actual liquidation, new securities have traditionally been distributed "according to their contractual and other rights determined *as though in liquidation*," and urged that, similarly, where the legislative policy of the Holding Company Act has precluded security holders of a holding company "from maintaining their respective interests in a going corporation," it is consistent with the bankruptcy precedents that those affected "should be given participations according to their contractual or other rights determined *as though in a continuing enterprise*, and that the process of compliance with the statute should not be permitted to mature liquidation preferences. In both instances the measure of participation allowed should compensate for the substantive rights of security holders as they would exist apart from the reorganization or other procedure in question." 13 S. E. C. 1, 9. An alternative statement of the same rationale was that "under the circumstances, fair and equitable compensation will be given to all of the claimants if their rights are measured not in terms of the situation created by the statute but rather in terms of the situation terminated

by it—i. e., as though no liquidation were to take place" (13 S. E. C. 1, 12).

In upholding the Commission this Court stated (*Otis & Co.* v. *S. E. C.*, 323 U. S. 624, 635):

> The Commission recognizes and applies the doctrine of full priority by giving value to the rights of the preferred in a going concern rather than as if by sale and distribution. [See also *Schwabacher* v. *United States*, 334 U. S. 182, 199.]

Elsewhere in the opinion it is stated that "rights of stockholders of a solvent company which is ordered by the Commission to distribute its assets among its stockholders may be evaluated on the basis of a going business and not as though a liquidation were taking place." (Ibid. p. 633.)

We believe that there is nothing in the Commission's or the Court's rationale in the *Otis* case which could be characterized as permitting, or requiring, valuation "as if the Act had never been passed" in the sense used by the court below. The decision on the part of the Commission and this Court to value on a going concern basis, rather than to treat the reorganization process of the Act as maturing liquidation preferences, was premised on the conviction that Congress intended Section 11 to operate without destroying legitimate investment values—i. e. without transferring value from one class of security holders to another. Because of the evidence of this intention in the legislative history

and because "Enforcement of an overriding public policy should not have its effect visited on one class with a corresponding windfall to another class of security holders,"[32] this Court concluded that "Congress did not intend that its exercise of power to simplify should mature rights, created without regard to the possibility of simplification of system structure, which otherwise would only arise by voluntary action of stockholders or, involuntarily, through action of creditors." 323 U. S. 624, 638.[33]

The *Otis* rationale of determining equitable equivalents in relation to going concern values rather than liquidation preferences did not in that case involve valuing the enterprise with prior divestments reinstated as if the Act had not been passed. Nor did the Commission value either the preferred or common stocks of Engineers on that basis. Thus the real thrust of the Court of Appeals' criticism of the Commission for inconsistency appears to be that since valuation of both preferred and common on the basis of their going concern values is to a limited extent equating what is received to rights which

[32] *Otis & Co.* v. *Securities and Exchange Commission*, *supra*, at p. 637.

[33] In the case of Engineers, liquidation through voluntary action of the stockholders would have resulted in the same payments as resulted from the Commission's valuation since the voluntary liquidation preferences coincided with the redemption prices of the preferred.

would exist apart from the Act, consistency requires the Commission to reconstitute the entire history of the holding company system as if the Act had not been passed.

There is no inconsistency, we submit, in applying a criterion of fairness to evaluate what is received and surrendered in a particular reorganization, and in not reopening prior consummated transactions so as to equate the rights received with what there would have been to surrender if the Act had never been passed.

(2) The hypothesis of losses attributable to the Act

The courts below appear to have taken it for granted that a reconstitution of Engineers' history since the Act would show that Engineers' common stockholders have suffered losses attributable to the Act. This assumption was one of the "colloquial equities" moving the district judge to conclude that in his judgment $100 a share was the proper amount to be paid each series of preferred (R. 290a–307a).[34] The Court of Appeals referred to "losses which were indubitably occa-

[34] The district court stated (R. 288a, n. 2):

"It is, of course, true that once the charter is not accepted as controlling, there is no reason why 100 is the necessary figure for a senior security holder to receive. It may be more or it may be less. But, in this case, after consideration of all factors involved, I conclude that $100 would be fair and equitable, but that the payment of premiums would not be fair and equitable."

sioned to the holding company enterprise by the sale of securities from Engineers' portfolio because of the divestitures required by the Act" (R. 34), but nevertheless decided that while the district court "may reject a plan, it cannot value the securities, find equitable equivalents therefor and substitute its own estimates for those of the Commission" (R. 39). The court stated with reference to the Commission's valuation duties that "if the equitable equivalents for relinquished securities are to be arrived at by the Commission under the doctrine of the *Otis & Co.* case, *ex* the Act, losses of the sort referred to in this paragraph must be weighed into the calculation, i. e., such losses should be returned to the credit side of the enterprise's balance sheet as a matter of bookkeeping" (R. 37).

We interpret the opinion of the Court of Appeals as holding that the Commission must compute in dollars and cents the extent that the overall impact of the Holding Company Act, or at least of Section 11 thereof, may have been harmful to Engineers common stock, in order to take such loss into account in determining how much less the preferred stockholders should receive than their investment values as of the date of the plan. Central Illinois, in its brief in opposition, disputes this interpretation and argues "that the Court had no intention of insisting upon the exact ascertainment and computation of each loss sustained by Engineers, but merely upon giv

ing reasonable consideration to the fact that such losses (without necessity for precise computation) had been sustained" (Brief in Opposition, Pt. IV, p. 34). We do not believe that this is a fair construction of the opinion of the Court of Appeals; for it is clear that the Commission did in its opinion consider the argument that losses had resulted from prior divestments. The Commission specifically found that the prior divestments did not result in the plan taking anything "unfairly" from the common (R. 72a).

The Commission itself rejected the hypothesis that Engineers' common stockholders had suffered losses as a result of the Act, pointing out in support of its view that marketwise the common stock increased in value from a low of 1⅛ in 1935 to 36 on February 13, 1946, the latest date covered in the hearings before the Commission, and that in all of its divestments Engineers had been free in its choice of methods and, within limits, in the choice of time for divestment. While the Commission concedes that it is impossible to demonstrate the relationship between this increase and the statute, the increase is in accord with the basic economic premise adopted by the Congress in passing the Act, namely, that holding companies such as Engineers with widely separated properties are disadvantageous from the point of view of security holders, as well as from the point of view of the public interest, and that their elimination adds rather than subtracts value

from the totality of security holders' interests affected.[35] We believe that experience with the administration of the Holding Company Act has tended to confirm this economic judgment, but, as we show below, we do not believe it practical in the case of the Engineers system or the holding company industry generally to attempt to support this economic judgment by an itemized reconstitution of events, as if the Act had not been passed.

[35] (See Appendix B, *infra*, pp. 129–130, 130–139.) Insofar as the court below has proceeded on the hypothesis that a holding company contributes to the earning power, and therefore to the intrinsic value, of assets which must be divested pursuant to Section 11, this case plainly demonstrates the insubstantiality of the assumption. Engineers' contribution to the management of its underlying subsidiaries was largely limited to financial matters and it seems clear that each of the subsidiaries was capable of operating independently in as economical a fashion as it operated under the aegis of Engineers. And even assuming that there was some economic value to the stockholders in the holding company, it was counterbalanced by the added costs incident to maintaining the separate corporate existence of Engineers and the salary costs of the personnel involved. See *In the Matter of Engineers Public Service Co.*, 12 S. E. C. 41 (1942). Moreover, Congress has repeatedly emphasized that Section 11, by providing the machinery whereby unproductive and unrelated entities may be severed from the system, preserves and increases the value of the enterprise, and has labeled the argument that the divestment process itself will result in loss of value due to forced liquidation "false." S. Rep. 621, 74th Cong., 1st Sess., p. 16. Experience has demonstrated repeatedly that there is a higher break-up value in holding company equities, and that the value of direct ownership in the underlying properties exceeds the value of the holding company stock.

(3) Impracticability of reconstituting Engineers balance sheet as if the Act had never been passed.

Confronted with the task of bringing about a sweeping reorganization of the more than 15 billion dollar industry subject to the Act, the Commission has necessarily adopted a step by step approach. If the Commission had been required to do the entire job of bringing about compliance with Section 11 in one comprehensive order for each holding company system, the issues of fact and law presented would have been so multifarious as to preclude the conclusion of administrative hearings, let alone the subsequent course of judicial review, without making the process interminable. But use of the step by step approach would be without substantial value unless each step could be treated as a unit, to be appraised with finality in its impact upon investors and consumers, and subjected to judicial review only within the time limits prescribed by the statute as applicable to individual Commission orders.

In accordance with this step by step approach and likewise we believe in conformance with universally applicable reorganization practice, the Commission has treated each reorganization plan presented to it as a unit and has applied the fair and equitable standard for the purpose of determining, with respect to the impact of the par-

ticular plan, whether what each class of security holders receives under the plan is the equitable equivalent of the rights surrendered as a result of the plan. In doing so it has invariably, and we believe inevitably, made its appraisal in the light of the then existing assets, liabilities and earning power of the company undergoing reorganization.

The opinion below indicates that the Commission should make use of hindsight to compensate for past decisions based upon necessarily inadequate foresight. The Commission itself has urged that down to the date of actual consummation of a reorganization the reorganization process should be sufficiently flexible to allow for reexaminations of allocations in the light of changed economic conditions. See *Knight* v. *Wertheim & Co.*, 158 F. 2d 838 (C. C. A. 2), certiorari denied *sub nom. McGuire* v. *Equitable Office Bldg. Corp.*, 331 U. S. 818; *In re Standard Gas & Electric Co.*, 63 F. Supp. 876 (D. Del.). Even in this area, however, it is necessary to strike a balance between the desirability of minimizing the risk of unfairness in allocations and the desirability of not making the reorganization process interminable.[36] Wherever this balance is to be drawn in the framework of a par-

[36] Cf. *Ecker* v. *Western Pacific R. Corp.*, 318 U. S. 448, 506–509; *Reconstruction Finance Corp.* v. *Denver & R. G. W. R. Co.*, 328 U. S. 495; *Insurance Group* v. *Denver & R. G. W. R. Co.*, 329 U. S. 607.

ticular reorganization proceeding, we believe that only chaos can result from opening up consummated plans and transactions to reevaluation in the light of hindsight, particularly where, as in this instance, the reexamination is not to readjust equities between parties to the transaction but to shift the burden of the impact of the consummated transaction in the relationship *inter sese* of security holders of one of the parties thereto.

a. *Puget Sound reorganization*

Thus the court below would have the Commission reexamine for the purpose of adjusting its impact upon Engineers' preferred and common stockholders a reorganization of Engineers' former subsidiary, Puget Sound Power and Light Corporation, approved by the Commission and the United States District Court for the District of Massachusetts in 1943. This reorganization, which did not affect the debt of the company, cleared up dividend arrears on publicly held prior preference stock through the issuance of additional preference stock, and substituted new common stock for the preexisting (junior) preferred stock and arrears and the old common stock. Engineers received approximately a 3% interest in the new common stock in return for its old holdings of 99.3% of common stock, estimated in the absence of reorganization to be from

18 to 34 years away from dividends. This interest it subsequently sold for $764,765.

The court below points to Puget Sound's net profit as they appear in Moody's Public Utility Manual for the years 1946 and 1947, and holds that since the figures there given exceed the estimates of average future earnings made by the Commission at the time it approved the recapitalization of Puget Sound, the reorganization and subsequent divestment of Puget Sound resulted in a loss to Engineers' common stockholders. Apart from the collateral nature of this attack upon the determinations made in the prior proceedings, we believe the court's computations are based upon a gross oversimplification of the complex problems involved in the Commission's evaluation of Engineers' interest in Puget and of the relationship between Engineers' interest in Puget Sound's earnings in 1943, when the recapitalization was ordered, and its hypothetical interest in those earnings today if no recapitalization had been ordered and the divestment had not occurred.

Indeed, the controversy over Puget Sound's recapitalization plan was concerned chiefly with whether Engineers was entitled to any interest in the new company in view of its junior position as to assets and earnings and the contingent character and remoteness of its interest in future

dividends.[36a] The Commission decided in favor of Engineers in awarding it a three percent interest in the new enterprise, free of prior claims upon income. Moreover, even if the Commission's forecast of Puget Sound's earnings and its actual earnings for 1946 and 1947 were otherwise comparable,[37] it would seem presumptuous to assume that earnings for those two years will represent an average for the system upon which interests in the enterprise should have been allocated.[38] In addition, it appears probable that good business management would have compelled, at some time, the recapitalization of Puget, and there is some possibility that the small interest Engi-

[36a] The book loss of more than $33,000,000 noted by the courts below (R. 19, n. 8) fails to reflect factors not caused by the Act (a) that the book investment (on Puget's books) represented $9,386,982 of write ups and (b) that there were $18,600,705 of dividend arrears. Deducting these two items, the Commission found a minus book value for the Puget common stock of $9,386,982 as of the time of the reorganization. See 13 S. E. C. 226, 232. These findings, offered by Engineers, are part of the unprinted record.

[37] It should be noted that the earnings figures which the court took from Moody's Public Utility Manual reflect (1) a depreciation allowance between $600,000 and $1,000,000 less than that which the Commission found appropriate in making its estimate of net earnings, (2) capital expenditures since 1943, and (3) divestment of certain properties after it ceased to be subject to the Public Utility Holding Company Act.

[38] Puget's president has stated that the gross income figure in 1948 will probably be $1,000,000 less than in 1947. Moody's Public Utility Manual Supplement, Volume 19, Page 1442.

neers could command in such a recapitalized company might have been sold aside from the compulsions of the Act.[39] As an alternative, Engineers might have been persuaded to make a substantial new investment in equity securities of Puget and it would be necessary to estimate the return from that investment as against other possible uses of Engineers' funds.[40]

[39] The book loss acted as a fund from which subsequent capital gains could be deducted. Thus $2,000,000 was used to set off the capital gains arising from the sale of certain assets (Engineers' Ex. 68, R. 1833a). If Virginia and El Paso had been sold about 22 million dollars more would have been available (R. 616a-623a). Secondly, there existed a strong possibility that Puget Sound would be purchased under the law of eminent domain by public power authorities in the State of Washington. In such event it then appeared probable that the interest of Engineers would be valued at much less than $764,765. Finally, the price received was arrived at by arm's length bargaining (R. 72a, n. 55). All of these considerations, none of which are associated with Section 11, undoubtedly weighed heavily with management in connection with their decision to dispose of Puget Sound at a particular time in a particular fashion.

[40] The published financial statements of Puget indicate that its working capital, which was approximately $980,000 on December 31, 1943, showed a deficit of $1,465,000 on December 31, 1947. This factor, plus the inadequate depreciation allowances being made and the reduced earnings forecast may lead to a need for additional financing in the near future. An attempt to recompute the consequences of the Puget reorganization would have to appraise this prospect also and any resulting dilution in the per share earnings attributable to the former Engineers' holdings—or in the alternative, the cost to Engineers in supplying the necessary capital itself.

Again, if it be assumed that the divestment of Puget was the result of Holding Company Act pressure, it would be necessary, if the effect of the Act upon the holding company system is to be calculated, to determine the effect of the withdrawal of the $764,765, which Engineers received from the sale of Puget from Engineers' general funds. These funds, including proceeds of other sales and retained earnings generally, were used to increase Engineers' investment in El Paso and Virginia [41] and to make payments to the preferred stocks of Engineers. It would also be necessary to recompute Engineers' taxes without reference to the tax advantages derived from the sale of Puget.

b. *El Paso Natural Gas Co. divestiture*

The court below also illustrates its determination of "substantial losses which occurred to Engineers" by pointing to a "loss" of "at least $4,000,000" which it states flowed from the divestiture of El Paso Natural Gas Company (R. 36–

[41] Virginia Public Service Company was acquired by Engineers and merged with Virginia Electric and Power Company (Virginia) when the Associated Gas and Electric system was compelled to divest itself of this subsidiary on the ground that its retention in the Associated system violated the standards of Section 11 and elected to accomplish the divestment by sale. Any increase in value gained by Virginia might therefore be termed an increase to Engineers due to the operation of Section 11. *Virginia Electric and Power Company — S. E. C. —* (1944), Holding Company Act Release No. 5021.

37). The history of Engineers' relationship with El Paso Natural Gas goes back to 1931, when Engineers loaned El Paso Natural Gas $3,500,000 and in return received $3,500,000 of bonds and an option to purchase 192,119 shares of its common stock. In 1936, after the passage of the Holding Company Act but prior to Engineers' registration with the Commission as a holding company, it became necessary to exercise this option in order to prevent its expiration. Accordingly, arrangements were effected whereby 57,119 shares of stock were obtained at $25 per share, options to purchase 16,576 were assigned to persons active in the management and financing of El Paso Natural Gas for $125,760, options to purchase 18,424 shares were assigned to Phelps Dodge Corp., and options for the purchase of 100,000 shares were permitted to expire. A five year trust was formed for the purpose of holding and selling the stock acquired by Engineers. These shares of stock were shortly thereafter split three for one, reducing their cost basis to $8.33 per share. Sixty thousand of the new shares were sold in 1936 for $19 per share and sixty thousand were sold in 1937 for $25 per share (R. 1484a-1485a, 1504a). Then, after Engineers registered with the Commission as a holding company, no more shares were sold by the trustee, and at the termination of the trust Engineers took direct title to the remaining 51,357 shares. These shares

were sold in March 1944, at an average price of $29.661 per share (R. 508a–509a).

As a result of these sales in 1936, 1937, and 1944 Engineers realized (in addition to the repayment of the loan), a profit of $2,700,000 from its El Paso Natural Gas investment. Nevertheless, the court below regarded the transactions as involving a loss "indubitably occasioned * * * by the Act" of at least $4,000,000, on the theory that but for the Act Engineers would have sold the shares at a higher subsequent value (R. 34, 37). The timings of these sales were not, however, compelled by Section 11, but were dictated by managerial judgment which must have reflected not only market judgments at the time but the advantage which management expected to derive from the cash proceeds.

The entire argument of losses due to sales of securities in a market lower than the present one presupposes a management so prescient that it will sell its stock holdings at the very peak of the market. Such omniscience, we submit, is not properly attributable to corporate management. Indeed, had the common stockholders who controlled the management of Engineers considered the prospect for appreciation of the El Paso stock disproportionate to prices obtainable, there is no reason why they could not have arranged to dispose of the Engineers' holdings of El Paso Natural Gas under a plan which en-

abled the common stockholders to retain this investment, as was done with the investments distributed under the instant plan.

Moreover, sale of the El Paso Natural Gas stock by Engineers did not preclude common stockholders of Engineers, if they so desired, from retaining an equivalent interest by directly purchasing El Paso Natural Gas stock on the market, or from the underwriting group which purchased it from Engineers. It is conceded, of course, that this would have required a fresh investment by common stockholders since the cash proceeds of the sale were not distributed by Engineers.

Computing the loss of profit that might have been realized if El Paso had been retained and sold at a later time is meaningless without attempting to draw a comparison between the profit Engineers did realize through retention of the cash proceeds of the sale. It is, of course, impossible to earmark the use made by Engineers of cash derived from a particular source. Thus, evaluation of the consequences of the El Paso Natural Gas sales is necessarily merged with a consideration of the over-all benefit to Engineers of the cash derived from a variety of sources including (a) the El Paso Natural Gas sale, (b) other sales, and (c) retention of what could have been declared in common stock dividends. Assuming with the courts below that the transactions by which Engineers realized or retained cash were all attributable to Section 11, it would still be

necessary to compare the hypothetical profits which might otherwise have been realized with the results of utilizing cash resources to build up the system and improve the common stock equity. If, for example, cash had not been so realized and retained, would the Engineers common stock have increased in market value from 1⅛ in 1935 to 37 in 1945, when the plan was filed? This is the utterly speculative type of inquiry which the opinion below appears to require of the Commission.

(4) The irrelevance of the issue of losses

Assuming *arguendo,* that there were losses as a result of the Act and that their existence and amount were ascertainable, the existence of such losses would not warrant according the preferred stockholders under the plan anything less than fair compensation for what they surrendered by the plan. The court below assumed that such losses would as a mere matter of bookkeeping require the Commission to allow preferred stockholders less than their investment value *ex* the plan. The opinion below states "such losses should be returned to the credit side of the enterprise's balance sheet as a matter of bookkeeping" (R. 37). We assume the court meant that such losses should be added to the asset side of the balance sheet. If this were done, however, the effect would be merely to improve the coverage for the preferred and thus strengthen the case

for finding an investment value in the preferred at least equal to the re-emption prices.

It is necessary, therefore, to take the further step of shifting the risk of loss from common to preferred stockholders before such a bookkeeping adjustment can affect the fairness of the plan's treatment of preferred and common stockholders. In other words, the losses must be added back only in computing what common stockholders receive, and not in determining whether preferred stockholders receive the equitable equivalent of what they surrender. Thus, the essence of the requirement of the court below is that the Commission shift from the common stockholders to the preferred stockholders all or a portion of the losses. If, however, the doctrine of strict priorities has any vitality at all, it precludes allowing the junior security holders to use the reorganization process to shift from the junior to the senior security holders the risk of losses from the prior operation of the enterprise. This is so irrespective of whether the management elected by the junior security holders may have had some responsibility for decisions which were a causal factor in producing the losses. The decision in the *Otis* case to value the United Light and Power preferred at its going concern value rather than on the basis of its liquidation preference, did not rest on any theory of requiring senior security holders to share losses which the

Act might otherwise impose upon the junior security holders. Instead it rested upon the Congressional purpose to prevent the very process of reorganization itself from creating a "windfall" by taking from the common stockholders and giving to the preferred stock values which, apart from the reorganization itself, inhered in the common stockholders' charter rights (See *supra*, pp. 28 *et seq.*).

F. *The miscellaneous "colloquial equities" upon which the district court relied and which the circuit inferentially considered appropriate in determining the equitable equivalent of what was surrendered are likewise irrelevant to such a consideration*

In addition to the circumstances surrounding past divestments, which we have already discussed, the district court cited as factors looking toward the nonpayment of the redemption prices of the preferreds the issue price and past market history of the preferreds and the difference between the dividend history of the preferreds and the dividend history of the common. The court below, although it did not refer to these nonvaluation criteria, upheld the right of the district court to reverse the Commission on these grounds, stating that "all pertinent factors and all substantial equities must be considered by the Commission" and concluded that "the District Judge did not err" in this respect (R. 38–39).

(1) The issue price and past market history

The $5 preferred was issued to the public for $100 per share, the $5.50 preferred for $99.50 per share, and the $6 preferred for $100 per share between 1928 and 1930. After the deduction of underwriting spreads it is estimated that the company received between $95 and $98 per share (R. 301a). It was these facts, which did not appear to the Commission to indicate the existence of any unusual circumstances, that the district court characterized as looking "toward nonpayment of premiums" (R. 288a). We believe the Commission, which simply appraised the current worth of the interest held by the preferreds, correctly declined to modify their valuation in the light of factors which might have been pertinent some 16 or 18 years before, when the then current money market had largely determined the issue price and underwriting spread of the preferred stocks. The correctness of this view was recently implied by this Court, *Schwabacher* v. *United States*, 334 U. S. 182, 199, in connection with a controversy over the proper criteria which the Interstate Commerce Commission should apply to determine the interest of a security holder in a merger. It was there said:

> In appraising a stockholder's position in a merger as to justice and reasonableness, it is not the promise that a charter made to him but the current worth of that promise that governs, it is not what he once put

into a constituent company but what value he is contributing to the merger that is to be made good.

The intervening market fluctuations in response to general economic conditions, the passage of the Holding Company Act and the course of progress thereunder, and all such similar circumstances are equally irrelevant in this regard. Nor does the amount for which the stock sold either initially or at some particular period in its history bear upon present value except in the most remote sense, as pointing to factors in the history of the enterprise which should be subjected to analysis. To that extent they were given full consideration by the Commission."[42]

(2) Dividend history

Another colloquial equity emphasized by the district court but not by the Court of Appeals was that "a significant reason why the present preferreds are able to be evaluated at more than

[42] It is interesting to note that if the issue price and market history of the common stock is analyzed on the same basis, it appears that the common stock receives, under the plan, more than "colloquial equities" would entitle them to receive. Thus, the average price at which the common stock was issued was $30.40 per share (R. 1820a). Accepting the value placed upon the interest received by the common stockholders in the Central Illinois brief in the court below of $33.90 (p. 84, n. 202) there appears to be a "bonus" of more than 10 per cent being paid the common by the plan. Comparing the market histories of the two securities we find no significant difference.

their redemption prices is because of retained earnings over a period of years not paid as dividends to the common stockholders" (R. 291a). Since the Court of Appeals omitted reference to this colloquial equity even in its summarization of the district court's reasoning, it may have agreed with the Commission's argument that at least this colloquial equity is irrelevant. On the other hand, the same logic which would require a reconstitution of the balance sheet of Engineers to determine what the balance sheet would have been if the Act had not been passed would seem to point to the necessity of deducting dividends that might have been paid but for the Act.

It is clear on the face of the record that the dividend policy was motivated by considerations dictated by the interests of the common stockholders, and that plans for compliance with Section 11 were a relatively minor factor in their motivation. In the first place, Engineers' witnesses freely conceded that they regarded it as in the interest of the common stockholders, from the point of view of minimizing Federal income taxes, to avoid receipt of dividends and instead to build up the equity value of the common stock upon which they might realize capital gains taxable on a more advantageous basis than dividends.[43]

[43] Engineers' Ex. 16, R. 1390a, shows that 72.54% of Engineers common stockholdings (as of June 30, 1945) were held

Of the $24,300,000 of undistributed earnings which the district court found had accrued to the interest of Engineers' common stockholders, Engineers' officers admitted that dividend "freezes" in the subsidiaries would have permitted only $9,868,000 to have been paid out in dividends. (R. 306a.) This amount roughly corresponded to the idle cash in the system which the management was anxious to apply through the plan to the retirement of preferred stock. The retained earnings, it was testified, "added materially to the value of the Preferred Stock because the funds, together with funds derived from the sale of properties, have been used in part to finance improvements and additions which have increased the earning power of the subsidiaries and in part to retire 60,346 shares of Preferred Stock of Engineers and El Paso of Delaware combined, at an aggregate cost of $5,894,227" (R. 470a). The

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by some 338 stockholders having in each case holdings of more than 500 shares. Referring to this Exhibit the Secretary of Engineers testified that "these relatively large unit holdings indicate ownership by people of substantial means, many of whom in all probability would prefer to have capital appreciation rather than dividend income * * *" (R. 462a. See also R. 556–557). While that testimony was given with specific reference to the tax impact of the plan it would appear equally relevant to motivation for the dividend policy antedating the plan. Engineers' secretary conceded that the tax factor had a bearing upon stockholders' attitude toward the dividend policy but expressed the opinion that the directors would have accumulated cash to retire the preferred stock "regardless of the tax law" (R. 920a–921a).

various dividend "freezes" were in part concessions made to obtain relatively cheap senior money for the operating companies, and, in the case of Virginia, in part to facilitate the merger with Virginia Public Service Company, which Engineers acquired from the trustees of Associated Gas and Electric Company in a transaction involving a relatively small amount of cash in proportion to the amount of properties acquired."

Assuming that the present relatively strong investment position of Engineers preferred is attributable to the managerial policies which dictated the retention of cash to build up the subsidiaries, nevertheless the plan accords the common stockholders the enhanced value of their residual equity as legitimate compensation for their self-restraint. Moreover, the benefit to the common

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[44] Engineers acquired from General Gas & Electric Corporation, a subsidiary holding company of Associated Gas & Electric Corporation, all of the common stock of Virginia Public Service Company and the claim of General Gas & Electric Corporation for certain escrow funds of about $1,165,000 for approximately $2,500,000. Upon acquisition of this stock Virginia Public Service Company was merged into Virginia Electric and Power Company. The Virginia Public Service debt securities were refunded through the issuance of debt securities by Virginia Electric & Power Company, and Engineers made a cash contribution of $2,500,000 to Virginia Electric & Power Company. As a result of these transactions Virginia Electric & Power Company acquired utility property of a gross book value of $52,510,000 and a net book value of $39,197,000 for net cash contributions on Engineers' part totalling $3,835,000. In the *Matter of Virginia Electric and Power Co.*, — *S. E. C.* — (1944), Holding Company Act Release No. 5058.

through building up the value of the subsidiaries, was obviously far greater than the indirect benefit to the preferred. In addition, the margin of coverage for the preferred stock was so substantial that even if the Engineers management had pursued relatively liberal dividend policies it is by no means clear that the resultant diminution of the coverage for the preferred would have brought it below the redemption price ceilings. It should be noted in that connection that the earnings coverage for the preferred which received the principal emphasis in the Badger testimony, and in the Commission's financial analysis, gave no effect to the potential earning capacity of the idle cash and relatively little to so much of the "cash equivalent" as was invested in low yield, short term, government securities.[45]

II. BOTH COURTS BELOW AND THE COMMISSISON CORRECTLY REFUSED TO TREAT THE INVOLUNTARY LIQUIDATION PREFERENCES SPECIFIED IN THE CHARTER OF ENGINEERS AS CONTROLLING

Neither court below accepted the common stockholders' contention that the Commission

[45] It should be noted that even if the entire unrestricted earned surplus as of December 31, 1945, were eliminated in the calculation of the asset coverage of the preferred it would only be reduced from $218.11 per share to $194.91 per share. If the unrestricted earned surplus should be eliminated from the capital account, the percentage of capitalization which the preferred stock represents, the ratio used by the Commission in its analysis, would be increased from 17.5 per cent to 18.3 per cent, less than 1 per cent.

erred in not according controlling weight to the charter involuntary liquidation preference, the district court stating "my present thought is that the rule of Otis & Co. applies . . ." (R. 288a, n. 2), and the Circuit Court stating "Neither the Commission nor the [district] court, in what we consider to have been a proper application of one of the principles enumerated by the Supreme Court in *Otis & Co.* v. *S. E. C.* (*The United Light & Power Company* case), 323 U. S. 624, 637, treated the charter provisions of Engineers as dispositive of the issues presented" (R. 34). Nevertheless, the common stockholders continue to urge that the charter involuntary liquidation preferences should determine the rights of the stockholders in the enterprise (see Central-Illinois petition in No. 266, pp. 5, 22–24).

Recognizing that, in the *Otis* case, the charter provisions were specifically held inapplicable to a dissolution pursuant to Section 11 of the Holding Company Act, the common stockholders contend that the *Otis* case is distinguishable chiefly on the ground that the dissolution of United Light and Power, in the *Otis* case, did not involve a dissolution of all the holding companies in that system. The plan involved in the *Otis* case provided for the dissolution of the top holding company as an initial step in bringing the system into compliance. There remained, under that plan, subsidiary holding companies in a still highly stratified system.

In justification for not treating the charter liquidation provisions as binding, an argument was advanced in that case that under the circumstances the enterprise was continuing in an altered form and without substantial change in the total of the inherent rights of the security holders. Significantly, however, this restrictive analysis of the case, which, if accepted, would have disposed of that issue, was expressly disavowed. This Court made it clear that the *Otis* doctrine did not depend upon the particular form of reorganization or liquidation selected as the vehicle for compliance with Section 11. Instead, the liquidation provisions of the United Light and Power charter were held inapplicable on the ground that Congress did not intend Section 11 to operate to mature charter rights. The Court said (at p. 638):

> *The reason does not lie in the fact that the business of Power continues in another form.* That is true of bankruptcy and equity reorganization. It lies in the fact that Congress did not intend that its exercise of power to simplify should mature rights, created without regard to the possibility of simplification of system structure, which otherwise would only arise by voluntary action of stockholders or, involuntarily, through action of creditors. We must assume that Congress intended to exercise its power with the least possible harm to citizens. [Italics added.]

The management of the United Light and Power system and the management of Engineers followed a different sequence of steps in complying with Section 11, probably because of the much higher degree of stratification in the United Light and Power system. However, the sequence of steps ought not to affect rights any more than should the particular method selected for accomplishing each step. Otherwise management, by its choice of procedure, would have the power to give preferential treatment to a particular class of security holders.[46]

Moreover, acceptance of this phase of the common stockholders' argument would permit the common stockholders of a one-story holding company such as Engineers to appropriate to themselves the entire residual value of the company's assets, subject to the necessity of according preferred stockholders only their charter liquidation preference no matter how great the disparity between that liquidation preference and the going concern value of the preferred stockholders' in-

[46] It should be noted that Engineeers, like United Light and Power in the *Otis* case, could have complied with Section 11 by merger or consolidation with a subsidiary. Indeed, this procedure was seriously considered until repeal of the excess profits tax eliminated the tax advantages of such a method of compliance. Engineers' charter expressly provided that a consolidation or merger which "does not substantially impair the rights and preferences of the preferred stock" should "not be regarded as a liquidation, dissolution, or winding up" for purposes of the paragraph defining liquidation preferences (R. 914a, 1413a).

vestment. Conversely, if the value of that one-story holding company's assets is found to be less than the liquidation preference of the preferred stockholders, the argument would permit the wiping out of the common stock despite a finding that, apart from the operation of Section 11, the common stock has a reasonable prospect of sharing in future earnings after satisfying the dividend preference of the preferred stock, including any arrears.

Nor do we believe that any specific language differences between the charter involved in the *Otis* case and the Engineers charter have any vital significance. The Engineers charter was drafted in 1925, four years prior to that of United Light and Power, and even if it be assumed that a charter provision making specific provision for the possibility of a Section 11 liquidation would be controlling, there appears to be no justification in the stereotyped phraseology of the two charters to attributing to the Engineers' draftsmen a greater degree of discernment and prescience.

Finally, common stockholders cite a number of cases in which the Commission approved plans calling for the payment of amounts equivalent only to the involuntary liquidation preferences of the securities involved, and contend that this precluded approval of the Engineers plan on the basis of what is termed "the Commission's new views." (Central-Illinois' petition in No. 266, p. 2?.) It is true that, in many instances, the Commission

has found that the equitable equivalent of a security to be surrendered was only its involuntary liquidation preference.[47] It is equally true, however, that many of these cases have stressed the absence of indication of any investment value in excess of that amount,[48] and other cases have per-

[47] Cases involving bond retirement: *The United Light and Power Company*, 10 S. E. C. 1215, affirmed *sub nom. N. Y. Trust Company* v. *S. E. C.*, 131 F. 2d 274 (C. C. A. 2); certiorari denied, 318 U. S. 786, rehearing denied, 319 U. S. 781; *North American Light & Power Company*, 11 S. E. C. 820, affirmed *sub nom. City National Bank & Trust Company* v. *S. E. C.*, 134 F. 2d 65 (C. C. A. 7); *North Continent Utilities Corporation*, — S. E. C. — (1943), Holding Company Act Release No. 4686, plan approved and enforced, 54 Supp. 527 (D. Del.); *Standard Gas and Electric Company*, — S. E. C. — (1944), Holding Company Act Release No. 5430, plan disapproved, 59 Supp. 274 (D. Del.), reversed, 151 F. 2d 326 (C. C. A. 3).

Cases involving participation by stockholders: *Lahti* v. *New England Power Association*, 160 F. 2d 845 (C. C. A. 1); *Buffalo, Niagara and Eastern Power Corp.*, — S. E. C. — (1945), Holding Company Act Release No. 6083; *Georgia Power & Light Co.*, — S. E. C. — (1945), Holding Company Act Release No. 5568, plan approved and enforced, Civil Action No. 133 (M. D. Ga. 1945); *Cities Service Power & Light Co.*, — S. E. C. — (1944), Holding Company Act Release No. 4944.

[48] *North Continent Utilities Corporation*, — S. E. C. — (1943), Holding Company Act Release No. 4686, plan approved and enforced, 54 F. Supp. 527 (D. Del.); *Consolidated Electric & Gas Company*, — S. E. C. — (1944), Holding Company Act Release No. 4900, plan approved and enforced, 55 F. Supp. 211 (D. Del.); *The Laclede Gas Light Company*, — S. E. C. — (1944), Holding Company Act Releases Nos. 5062 and 5071, plan approved and enforced, 57 F. Supp. 997 (E. D. Mo.), affirmed *sub nom. Mass. Mutual Life Ins. Co.* v. *S. E. C.*, 151 F. 2d 424 (C. C. A. 8), certiorari

mitted the retirement of senior securities for amounts in excess of the involuntary liquidation preference."

denied, 327 U. S. 795; *Standard Gas and Electric Company*, — S. E. C. — (1944), Holding Company Act Release No. 5430, plan disapproved, 59 F. Supp. 274 (D. Del.), reversed, 151 F. 2d 326 (C. C. A. 3), certiorari denied, 327 U. S. 797. See also *New England Power Association*, — S. E. C. — (1946), Holding Company Act Release No. 6470, plan approved and enforced, 66 F. Supp. 378 (D. Mass.), affirmed *sub nom. Lahti v. New England Power Association*, 160 F. 2d 845 (C. C. A. 1); *Interstate Power Company*, — S. E. C. — (1947), Holding Company Act Release No. 7159, plan approved and enforced, Civil Action No. 4063 (D. Del. 1947).

[49] *The Western Public Service Co.*, H. C. A. R. Nos. 3175, 3230, 3245 (1942) and *El Paso Electric Co.* (Delaware), 8 S. E. C. 366, which were subsidiaries of Engineers; *Mississippi River Power Co.*, H. C. A. R. No. 5776 (1945); *The North American Co.*, H. C. A. R. No. 5796 (1945); *Minnesota Power and Light Co.*, H. C. A. R. No. 5850 (1945); *N. Y. Pa. N. J. Utilities Co.*, H. C. A. R. No. 5975 (1945); *Buffalo, Niagara and Eastern Power Corp.*, H. C. A. R. No. 6083 (1945); *Pennsylvania Power & Light Co.*, H. C. A. R. No. 6167 (1945); *American Power & Light Co.* — S. E. C. — (1945), H. C. A. R. No. 6176; *Standard Gas and Electric Co.*, H. C. A. R. No. 6435 (1946), following the decision in *Standard Gas & Electric Co.*, 63 F. Supp. 876 (D. Del.); *Community Gas & Power Co.*, H. C. A. R. No. 6436 (1946); *Scranton Spring Brook Water Service Co.*, H. C. A. R. No. 6458 (1946); *Northern States Power Co.*, H. C. A. R. No. 6578 (1946); *Pennsylvania Edison Co.*, H. C. A. R. No. 6723 (1946); *Washington Railway & Electric Co.*, H. C. A. R. No. 7410 (1947), enforced June 16, 1947 (D. C. Dist. of Col.); *In re United Gas Corp.*, 58 F. Supp. 501 (D. Del); *In re Central & Southwest Utilities Co.*, 66 F. Supp. 690 (D. Del.); *In the Matter of American and Foreign Power Company*, unreported, decided Sept. 21, 1948 (D. S. D. Me.) Civil Action No. 490; *Pennsylvania Edison Co.*, — S. E. C. —

It seems unnecessary, in view of this Court's unequivocal holding in the *Otis* case that Section 11 does not mature liquidation preferences, to defend the challenge to the administrative consistency of the Commission offered by the common stockholders.[50] However, we believe it is entirely clear from the Commission opinions that each case involved a progressive analysis of the problems presented, and that the peculiar problems of each new case were considered in view of the accumulated administrative experience. The instant case involved no more than an application to a new state of facts of the principles developed and foreshadowed by prior holdings.

(1948), H. C. A. R. No. 8550. (Decided after the decision below.) Most of these cases were not approved as part of a Section 11 (e) plan due to their nature, for where management agrees that payment of the redemption price is fair and equitable the normal procedure simply requires a call of the security.

[50] In the *Otis* case itself the petitioner urged that the Commission's decision was inconsistent with the earlier *New York Trust Co.* case, and also that a consistent application of the standard of fairness applied by the Commission might require a payment in excess of liquidation preference to a preferred stock having a high dividend rate relatively free of risk in view of earnings and asset coverage. The Commission pointed out that it had not yet had occasion to deal with this problem, but that "we would scarcely regard it as a valid criticism of the standard of fairness applied in this case, that it might under converse circumstances prevent common stockholders from obtaining through operation of Section 11 a windfall at the expense of preferred stockholders." See Point I 2 (b) of the Government's brief, pp. 49, 54, October Term 1944, No. 81.

New York Trust Co. v. *S. E. C.*, 131 F. 2d 274 (C. C. A. 2), on which the common stockholders have placed their chief reliance, was the first case in which a Section 11 (e) plan called for prepayment of debt at its face value where the indenture contained an option to call the debt at a price higher than the face amount of the debt. It was there held that since the venture had been frustrated by government edict performance of the contract according to its terms was excused. Accordingly, payment of the debt at face amount was permitted prior to maturity. However, this holding does not warrant prepayment of debt at the face amount where it appears the debt would have a value in excess of that amount. See *American Power & Light Co.*, — S. E. C. — (1945), Holding Company Act Release No. 6176. In the case of preferred stock, moreover, what is involved is an ownership interest in the enterprise—not a creditor claim of a definite principal amount against it.

Insofar as there is any issue of constitutionality raised by the plan, we believe it has been resolved by this Court's opinion in the *Otis* case. That portion of this Court's opinion which deals with the possible application of the gold clause cases contains no suggestion of a "constitutional doubt" as to the overriding force of the commerce power if it had been concluded that the charter liquidation preference was applicable but would thwart

the legislative purpose. Insofar as there must be a choice between a restrictive interpretation of a private contract as applied to a situation not specifically envisaged, and a restrictive interpretation of the Congressional purpose to bring about simplification of holding company systems with the least possible harm to investors, it is obvious that it is the Congressional policy, not the private stipulation, which must receive the benefit of the doubt. This at least was the approach of the majority of the Court in the *Otis* case. Only if Section 11 (e) were construed in accordance with the common stockholders' contentions to benefit the common at the expense of the preferred stockholders would there appear to be any serious constitutional issue.

III. THE COURT BELOW ERRED IN HOLDING THAT THE DISTRICT COURT'S INDEPENDENT RESPONSIBILITY FOR APPROVAL OF THE PLAN INCLUDES A POWER TO REJECT THE RESULTS OF THE COMMISSION'S VALUATION ON THE BASIS OF A DISCRETIONARY WEIGHING OF IMPONDERABLE "COLLOQUIAL" OR "SPECIAL" EQUITIES.

The Commission believes that the basic issue in this case is the proper legal standard which should control both the Commission and the district court in their consideration of the plan. We have argued in Points I and II that the Commission applied a proper legal standard in according Engineers' preferred stockholders full compensation for their undisputed going-concern values; that the colloquial or special equities relied on by the

courts below are irrelevant to the fair and equitable standard; and that as the Commission and both courts below held, the involuntary liquidation preferences of Engineers' preferred stocks are not controlling. If this is a correct interpretation of "fair and equitable," neither the Commission nor the district court had any discretion to diminish the participation of the preferred stockholders, inasmuch as they did not dispute (R. 67a and p. 28, *supra*) the Commission's finding as to going-concern value of the preferred, if that were assumed to be the proper test. If, on the other hand, the Commission did not apply the correct rule of law as to the rights of the stockholders, then of course the district court properly discharged its own statutory responsibility in refusing to approve the plan as approved by the Commission.

While the Court of Appeals' criticisms of the Commission's valuation methods seem to us to present issues of law, it did not express them as controlling legal standards, and did not purport to decide whether the Commission's conclusion lacked "any rational and statutory foundation." (R. 21.) Its holding that the district court did not err in finding the plan as submitted by the Commission unfair is qualified with the statement, "Certainly we cannot say that this conclusion was clearly erroneous" (R. 39). The Court of Appeals held that a question of law which "goes to the heart of the instant con-

troversy" is the extent of the power conferred on the district court by Section 11 (e) to reject determinations of the Commission (R. 20). We believe this is a correct statement of the issue only if, contrary to our interpretation, the "fair and equitable" standard of Section 11 (e) lodges in either Commission or court a discretion whether to accord Engineers' preferred stockholders the full going concern value of their interest or something less.

The Court of Appeals held that a district court under Section 11 (e) has a much broader power to reject the Commission's valuations than where the fairness of the plan is presented directly to a Court of Appeals by a petition to review under Section 24 (a) of the Act. Section 24 (a) is the provision of the Act applicable in terms to judicial review by any person aggrieved "by an order issued by the Commission under this title." It expressly provides for review in a Court of Appeals upon the transcript of the record made before the Commission and under the substantial evidence rule.

Commission orders approving plans under Section 11 (e) may be the subject of petitions to review under Section 24 (a), and, indeed, since Section 11 (e) provides for court enforcement of plans only at the request of the proponent company, Section 24 (a) affords the only avenue of review under Section 24 (a), and, indeed, since enforcement. The Section 24 (a) avenue of re-

view has in fact been followed in a number of cases. See *S. E. C.* v. *Chenery Corp.*, 318 U. S. 80; 332 U. S. 194; *New York Trust Co.* v. *S. E. C.*, 131 F. 2d 274 (C. C. A. 2), certiorari denied, 318 U. S. 786, rehearing denied, 319 U. S. 781; *Phillips* v. *S. E. C.*, 153 F. 2d 27 (C. C. A. 2), certiorari denied, 328 U. S. 860. Where a plan by its terms contemplates court enforcement, and the Commission's approval order expressly conditions its authorization to consummate the transactions proposed by the plan upon the entry of an enforcement order under Section 11 (e), direct review of the Commission's order under Section 24 (a) has been held unavailable. *Okin* v. *S. E. C.*, 145 F. 2d 206 (C. C. A. 2); *Lownsbury* v. *S. E. C.*, 151 F. 2d 217 (C. C. A. 3), certiorari denied, 326 U. S. 782.[51]

Thus the proponent company, or rather its management, can, by requesting court enforcement, channel judicial review through the district court, or, by not requesting enforcement, allow objectors to seek review in a Court of Appeals.

[51] The reasons urged by the Commission for this position were in part that Congress could not have intended both avenues of review to be applicable to the same order, and in part that a Commission order which is to be operative only after a subsequent enforcement order of the district court is interlocutory in nature with reference to review elsewhere than in the enforcement court. This was the rationale of the Second Circuit in the *Okin* case. The opinion of the Third Circuit was based upon the *Okin* case. Judge Biggs, however, in a separate concurring opinion, expressed the view that the district court should adjudicate "all questions relating to integration, simplification and the fairness and equity of the plan" (at p. 220).

Such a choice on management's part seems to us consistent with the statutory purpose only if its exercise cannot affect the ultimate allocation of assets between classes of security holders. The latitude for managerial initiative was provided in the hope that "if the compulsions of the act are made sufficiently clear to convince the interlocking lawyers of the holding-company bankers that it can't be evaded or compromised, the legal and economic imagination which put these holding-company combinations together will devise many means of taking them apart." Additional views of Congressman Eicher appended to House Report No. 1318, 74th Cong., 1st Sess., pp. 44, 50.[52]

Management is not likely to be neutral, however, upon the vital issue of the fairness of the allocation. Congress could hardly have intended to permit management to determine the scope of judi-

[52] Management may legitimately desire an enforcement proceeding in order to obtain the protection of a court decree enjoining future challenge to the plan or to preclude state court injunction suits actually threatened. In other situations, depending upon the nature of the plan, it may be thought that Commission approval itself is sufficient protection to the management in carrying forward the plan in the absence of opposition. Again where opposition appears and is prepared to take the case promptly to a court of appeals, district court enforcement may appear unnecessary to obtaining a final determination of the challenge to the plan. Procedural strategy directed to timely consummation of a proper plan would thus clearly accord with the objectives of Section 11 (b) to carry out compliance "as soon as practicable."

cial review of that issue.[53] Management would have such a power if given a choice between a forum in which the reviewing court would be bound by a reasonable Commission decision and a forum in which it would not. It is thus plainly not desirable that the scope of review by a district court under Section 11 (e) be substantially greater than that by a court of appeals under Section 24.

It is our position that the analogy to Section 77 of the Bankruptcy Act, upon which the court below relied, does not warrant reading a widely different scope of review into Section 11 (e) than would apply under Section 24;[54] that the issue in this case, if not a pure issue of law, must be one of policy which would be for the Commission to decide under any theory of the scope of review; and that in any event Congress could not have intended judicial review to check the Commission without imposing a controlling standard to govern its reconsideration of the plan after rejection by a district court.

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[53] *Cf.* Senate Report No. 621, 79th Cong., 1st Sess., p. 33, p. 143, *infra*, which states with reference to subsections (d), (e) and (f) of Section 11:

"Under these subsections, Commission approval of reorganization plans and supervision of the conditions under which such plans are prepared will make it impossible for a group of favored insiders to continue their domination over inarticulate and helpless minorities, or even as is often the case, majorities."

[54] There are certain procedural differences between enforcement proceedings brought under Section 11 (e) and review

A. *Section 11 (e) grants to the district court a scope of review similar to that exercised in the district court under Section 77 of the Bankruptcy Act*

Section 11 (e) parallels Section 77 of the Bankruptcy Act in providing for an administrative hearing on a plan prior to judicial consideration thereof and a subsequent judicial hearing at which the court must also approve the plan. In contrast with the relatively detailed articulation in Section 77 of the respective functions of the Interstate Commerce Commission and the court, Section 11 (e) deals in two sentences with the Commission's function and in one with the district court's. This brevity of Section 11 (e) makes it necessary to turn to the closest similar arrangement for an understanding of the interrelationship which was contemplated.

The similarity between Section 77 and Section 11 was specifically adverted to in the course of the legislative history of the Holding Company Act. Section 11 (f) of the Holding Company Act, which deals with proceedings in the Federal courts for the reorganization of registered holding com-

by a Court of Appeals under Section 24 (a). These, including the equity court's responsibility in the exercise of an independent judgment to review the Commission's determination even in the absence of articulate opposition, are discussed below. These procedural differences, however, are not such as to permit one standard of fairness to pretail under Section 24 (a) and a substantially different one under Section 11 (e).

panies or subsidiaries "whether under this section or otherwise" (including proceedings for the reorganization of insolvent companies), provides that no plan of reorganization for a registered holding company or a subsidiary in such a proceeding shall "become effective unless such plan shall have been approved by the Commission after opportunity for hearing prior to its submission to the court." It was on this subsection rather than Section 11 (e) that debate was directly focused.

In the course of debate on the Senate floor Senator Borah asked with reference to the above quoted language of Section 11 (f) (79 Cong. Rec. 8845):

> I do not exactly understand that language. Does it mean that the court's jurisdiction with reference to the reorganization, or what shall be permitted by decree of the court, is limited; or is it simply recommendatory to the court?

Senator Wheeler replied:

> We do exactly the same thing at the present time, as I understand, with reference to the Interstate Commerce Commission. A plan for the reorganization of a railroad is supposed to be submitted to the Interstate Commerce Commission for its approval before it is approved by the court. We put this provision in here in practically the same manner, as I recall, as the existing provision with reference to the

Interstate Commerce Commission in the case of railroad reorganizations.

As the Court of Appeals for the Second Circuit has held, the succession of the responsibility in Commission and district court under Sections 11 (e) and 11 (f) are so similar as to make it clear that Congress intended the analogy to apply in both instances. See *Okin* v. *S. E. C.*, 145 F. 2d 206, 208, n. 2 (C. C. A. 2).

The court below agreed that the duties of the Section 11 (e) court with reference to the prior determinations of the Securities and Exchange Commission are similar to those of the Section 77 court with reference to the Interstate Commerce Commission (R. 29, 33). However, we believe the court misinterpreted the scope of review which is exercised by the Section 77 court, and correspondingly misinterpreted the scope of review under Section 11 (e).

B. *The scope of review under Section 77 and Section 11 (e)*

The court below held that both under Section 77 and under Section 11 (e) the District Court is intended to "function as an equity reorganization tribunal with the powers and functions of such a court, and not as a mere review court" (R. 30). This conception was more fully expressed with reference to the Section 77 court (R. 29):

> We are of the opinion that Congress intended the district courts of the United States, within the limitations of the statute, to function as equity reorganization courts. Though the Commission must make the primary determinations respecting the plan, including, in particular, those relating to valuations of railroad securities, the court must exercise its own independent judgment in approving or disapproving the plan whether the court's rulings relate to value, or to some other pertinent subject. See In re Erie R. Co., 37 F. Supp. 237, 243–245, aff'd, 6 Cir. 133 F. 2d 730, cert. den. 320 U. S. 748.

Similarly, the court concluded with reference to Section 11 (e): "that Congress intended to lay substantially the same duty on the court in the second instance as it imposed on the Commission in the first." (R. 24.) The court also held (R. 33–34):

> The [district] court may not substitute its valuations for those of the Commission *but it may reject* valuations made by the Commission in fulfilling its, the court's statutory function in determining whether the plan is fair and equitable. The court of course may not act capriciously in rejecting valuations made by the Commission nor may the Commission act with caprice in valuing securities. The judicial process is brigaded with the administrative process of the Commission but this does not mean that the court in the field allocated to it

> by Congress is not to exercise its independent plenary judgment as an equity reorganization tribunal upon every matter relating to the fairness and equity of the reorganization.
>
> * * * The findings and conclusions of the Commission were not binding upon the learned District Judge though, as was proper, he treated them with respect. * * * [Italics supplied.]

In so holding, we believe the court below misinterpreted the scope of review of the Section 77 court, and misconceived what is meant by the exercise of an "independent plenary judgment" to reexamine administrative findings.

This Court decided in *Ecker* v. *Western Pacific R. Corp.*, 318 U. S. 448, 473 that as to matters of valuation and allocation the Section 77 court reviews the determinatons of the Interstate Commerce Commission under the substantial evidence rule.

> The language chosen leaves to the Commission, we think, the determination of value without the necessity of a reexamination by the court, when that determination is reached with material evidence to support the conclusion and in accordance with legal standards. It leaves open the question of whether in reaching the result the Commission had applied improper statutory standards.

Counsel for Central Illinois, while not challenging the view that Section 11 (e) was intended

to parallel Section 77, urged in the court below that "clearly [this view] represents the most favorable view of the Commission's jurisdiction which the legislative history permits since Section 77 contains express provisions (entirely absent from Section 11 (e)) conferring on the Interstate Commerce Commission exclusive powers over 'valuation of the debtor's property'." (Brief, pp. 16–17.) In that connection reference was made to subsection (e) of Section 77, quoted at 318 U. S. 472, which provides in part:

> If it shall be necessary to determine the value of any property for any purpose under this section, the Commission shall determine such value and certify the same to the court in its report on the plan.

It will be noted that the language adverted to does not expressly make valuation an "exclusive" function of the Interstate Commerce Commission. Section 11 (e) is less explicit than Section 77 in spelling out subsidiary steps in the process by which both agency and court reaches the conclusion that a plan is "fair and equitable", but in specifying that the district court "after notice and opportunity for hearing, shall approve such plan as fair and equitable. * * *"[35] Section

[35] The court below said with reference to this language (R. 24):

"The words employed respecting the respective duties of Commission and court are so alike that we must conclude that Congress intended to lay substantially the same duty on the court in the second instance as it imposed on the Commission in the first."

11 (e) closely parallels what is specified in subsection (e) of Section 77:

> After such hearing, and without any hearing if no objections are filed, the judge shall approve the plan if satisfied that: (1) it complies with the provisions of subsection (b) of this section, is fair and equitable, affords due recognition to the rights of each class of creditors and stockholders, does not discriminate unfairly in favor of any class of creditors or stockholders, and will conform to the requirements of the law of the land regarding the participation of the various classes of creditors and stockholders; * * *

quoted by this Court at 318 U. S. 464. Nevertheless, the judge's task under Section 77 was held to be a mere review function with reference to the Interstate Commerce Commission's valuation.[56]

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[56] Conversely, in dealing with subsection (c) (2) of Section 77, where the statute is explicit concerning the Interstate Commerce Commission's responsibility for fees but not as to judicial review thereof, the traditional relationship between fact-finding agency and court has been implied. The provision in question provides:

> * * * "the trustee or trustees and their counsel shall receive * * * such compensation as the judge may allow within a maximum approved by the commission." *Cf.* subsection (8) dealing in similar language with compensation and reimbursement of other persons.

As to this, the Court held in *Reconstruction Finance Corp. v. Bankers Trust Co.*, 318 U. S. 163, 170:

> "Our conclusion is that the function committed by the law to the Commission is the ordinary one reposed in a fact find-

An even more explicit provision in Section 77 for judicial reexamination of the Interstate Commerce Commission's determination is the provision of Section 77 (e) that a plan which allows nothing to particular classes of stockholders or creditors need not be submitted to them if the worthlessness of their claims is found by the Commission "and the judge shall have affirmed the finding." With respect to that language the opinion in the *Western Pacific* case states (at pp. 478–479):

> The specificity of the direction for reexamination of the Commission's action points to a wider scope of review than an inquiry as to whether statutory standards for valuation have been followed * * * But we think the requirement of affirmation of the exclusion of claimants does not require an independent appraisal of the valuation which ordained their elimination. The court properly affirms the Commission, when it finds no legal objection to the Commission's use of its own valuation to determine whether particular claimants are entitled to participate in the reorganization. For example, there may arise controversies over the priority of the validity of claims. A Commission finding involving such problems would require an independent examination and an affirmation by the court.

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ing body and that its findings, supported by evidence, may not be disturbed by a court."

The opinion of the Circuit Court of Appeals, which this Court reversed, had indicated that the district court in deferring to the Commission's knowledge of valuation matters may have misconceived its function since "the court is not concluded by any determination made by the Commission, but may, and must, exercise its own independent judgment; and this is true whether such determination relates to value or to some other subject." *In re Western Pacific R. Co.*, 124 F. 2d 136, 140 (C. C. A. 9), quoted at 318 U. S. 448, 466. This language, which this Court rejected, is strikingly similar to the views expressed by the court below (R. 33–34, p. 93, *supra*).[37] The holding in the *Western Pacific* case that Commission findings as to value are subject to the usual rules governing judicial review was reaffirmed in *R. F. C.* v. *Denver & R. G. W. R. Co.*, 328 U. S. 495, 505–509, in which this Court said:

> The basic problems of railroad reorganization under § 77 of the Bankruptcy Act have been so recently considered by this Court in the *Western Pacific* and *Milwaukee* cases that only a summary reference to their conclusions attacked by respondents need to be made now. * * * The agencies employed by Congress to accomplish

[37] The common stockholders relied below on *Group of Investors* v. *Milwaukee R. Co.*, 318 U. S. 523; but nothing in that case, decided the same day as the *Western Pacific* case, is in any way inconsistent with the latter decision.

> reorganizations under § 77 were the Interstate Commerce Commission and the courts. The answer reached by Congress was that the experience and judgment of the Commission must be relied upon for final determinations *of value* and of matters affecting the public interest, *subject to judicial review to assure compliance with constitutional and statutory requirements*. This was the interpretation of all members of this Court from the language of the act and the evidence of congressional purpose in the hearings, reports and discussion. To the courts, Congress confided the power to review the plan to determine whether the Commission has followed the statutory mandates of subsection (e), 318 U. S. at 477, and whether the Commission had material evidence to support its conclusions. 318 U. S. at 477; concurring opinion at 512. [Italics supplied.]

The courts of appeals have likewise construed the holdings of this Court as making the role of the Section 77 judge in relation to Commission valuations and allocations that of applying the substantial evidence rule. See *In re New York, New Haven & Hartford R. Co.*, 147 F. 2d 40, 46–47 (C. C. A. 2), certiorari denied, 325 U. S. 884; *Chicago, Rock Island & Pacific Ry. Co.* v. *Fleming*, 157 F. 2d 241 (C. C. A. 7), certiorari denied, 329 U. S. 780, 811.

The opinion of the court below (R. 21-22) quotes specific statements from the legislative history concerning the anticipated relationship of district court and Commission under Section 11. While the holding of the court does not appear to rest on these quotations, some of them appear to us to give an incomplete picture of the legislative background. Accordingly, we set forth in full in Appendix B the entire discussion of the mechanism of Section 11 in the Senate Report from which the excerpts quoted in the opinion below are taken, and also the entire Senate debate on certain amendments to Section 11 (f) which the opinion quotes in part.[58] Read in context, the references in the committee report to the anticipated advisory function of the Commission relate to the Commission's status as a party to proceedings or as a court-appointed trustee, administering plans or properties, rather than to the court's reexamination of a plan theretofore approved by the Commission in an administrative hearing. The debate over the respective functions of Commission and court, and the amendments prompted thereby, reflect a controversy as to whether there should be any limitation upon the reorganization court's tra-

[58] The debate mentions only Section 11 (f), but, as the opinion below notes, there were corresponding provisions of subsections (d) and (e) of the bills relating to the court's duty to appoint the Commission sole trustee which underwent corresponding revision.

ditional discretion as to the choice of a trustee. There is no indication in the entire debate of any difference of opinion concerning the desirability of giving the Commission the same power with reference to approval of reorganization plans as was accorded the Interstate Commerce Commission under Section 77.

Apparently the court below was misled by references to the function of the reorganization court to exercise an "independent judgment", both in the opinions of this Court dealing with Section 77 of the Bankruptcy Act and in Senator Wheeler's statement comparing Section 11 (f) of the Holding Company Bill with Section 77: "In other words, there is really a double-check upon the plan, and final determination rests as in the past in the courts." See Appendix B, *infra*, p. 152, quoted by the court below (R. 22–23). But the decisions of this Court under Section 77 of the Bankruptcy Act have found ample scope for the exercise of "independent judgment" by the reorganization court without holding that the court's responsibility for valuation and allocation approximates the initial fact finding function of the Interstate Commerce Commission. See especially the *Western Pacific* and *Denver and Rio Grande* cases discussed *supra*, pp. 94–99.[59]

[59] We believe it significant that the court below did not refer to the *Western Pacific* decision, but relied only upon a district court ruling in the *Erie* case prior to the *Western Pacific* case (R. 29). Moreover, as we read the opinion of

As this Court said in *St. Joseph Stock Yards Co. v. United States*, 298 U. S. 38, 53, in dealing with a suit to set aside a rate determination under the Urgent Deficiencies Act:

> * * * this judicial duty to exercise an independent judgment does not require or justify disregard of the weight which may properly attach to findings upon hearing and evidence. On the contrary, the judicial duty is performed in the light of the proceedings already had and may be greatly facilitated by the assembling and analysis of the facts in the course of the legislative determination. Judicial judgment may be none the less appropriately independent because informed and aided by the sifting procedure of an expert legislative agency.

The reorganization court, of course, has an independent responsibility for all issues of law. The *Western Pacific* opinion give as an example; "there may arise controversies over the priority or the validity of claims", 318 U. S. at 479. Again, the *Milwaukee* case (*Group of Investors* v. *Milwaukee R. Co.*, 318 U. S. at 568) held that it was for the district court to resolve a dispute as to whether certain properties were subject to the

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the master which the district court adopted in the *Erie* case, it held that exercise of independent judgment in determining whether the plan complies with the requirements of Section 77 involves merely a review of the prior determinations of the Interstate Commerce Commission to see whether they were in accordance with accepted legal standards and supported by material evidence (37 F. Supp. 237, 244, 245, 247).

after acquired property clause of the General Mortgage.[60]

A traditional function and responsibility of the reorganization courts, as developed in the equity receivership cases, is to exercise "an informed, independent judgment" as to all matters arising in the reorganization. See *National Surety Co.* v. *Coriell*, 289 U. S. 426, 436; *First National Bank* v. *Flershem*, 290 U. S. 504. While this concept developed in situations where there was no administrative agency charged with responsibility for protecting security holders against possibly inadequate, or at least not disinterested, representation, this judicial function survives in part, and gives the court a broader function than the mere determination of questions of law, under both Sections 77 and 11 (e).

Thus, within limits, the district judge has responsibility to take evidence to decide whether the record on which the agency acted has become stale as a result of changing economic conditions. See *R. F. C.* v. *Denver & R. G. W. R. Co.*, 328 U. S. 495, 521–22; *Insurance Group* v. *Denver & R. G. W. R. Co.*, 329 U. S. 607, 611. Inquiries as to matters of law or fact may be made on the court's own motion or at the behest of objecting parties

[60] See also *In re New York, N. H. & H. R. Co.*, 147 F. 2d 40 (C. C. A. 2), where the Court of Appeals reversed both the district court and the Commission for making an allocation on the basis of negotiations by the conflicting groups rather than on the basis of an exercise of the Commission's own valuation function.

who, by ordinary appellate standards, might be precluded from raising a question. For example, in *Comstock* v. *Group of Investors*, 335 U. S. 211, the Interstate Commerce Commission had given no consideration at all, because the point had not been raised before it, to the argument that securities of a parent holding company should be subordinated to otherwise junior holdings of public securities in view of evidence of mismanagement allegedly similar to that involved in *Taylor* v. *Standard Gas and Electric Co.*, 306 U. S. 307. This Court held the district court might, in its discretion, consider these objections for the purpose of determining whether the circumstances warranted a remand to the Commission.[61]

[61] The Court indicated (at pp. 227–8) that the objection should have been voiced before the Commission in the first instance and that "to by-pass the Commission and make the court the original forum for such contentions is not to be encouraged." It was nevertheless held that—

"In view of the functions cast upon the court in such cases, we cannot say that it may not, in its discretion, consider objections on their merits even though they have not been presented to the Commission. Some circumstances might be disclosed to indicate a remand for their consideration by the Commission. They might indicate that the courts would withhold approval, not out of deference to the objecting parties' rights but because of the broad responsibility laid upon the court for the equity and fairness of the plan as a whole. The court will be diligent to protect itself and the public from approval of unfair plans, even by default, and may take for its own use evidence no party would have a right to force upon it. The court below evidently considered the circumstances of this case to warrant such inquiry into the merits, and we do not inquire whether the discretion was wisely exercised."

As the court below noted, the Commission itself has emphasized the "independent duty" of the Section 11 (e) court (R. 23–24). In cases arising under Section 11 (e) the Commission has consistently taken the position that the enforcement court has an independent responsibility to scrutinize the plan even in the absence of opposition, or where the opposition might be belated from the point of view of ordinary review proceedings. In the *Otis* case there had been no opposition to the plan in the administrative hearings, and the United Light and Power Company on that ground resisted the standing of Otis & Co. to appear in the district court in opposition to the plan and to appeal from the adverse order. In both instances the Commission supported the standing of Otis & Co., with the *caveat* that their grounds of opposition related to an issue fully raised before the Commission in the dissenting opinion of Commissioner Healy and in fact basic to the obligations of both Commission and court in respect to examination of the plan. Accordingly, it was not, in the Commission's view, a case where the nature of the opposition amounted to "ambushing" the Commission as was urged by United Light and Power. *Cf. Comstock* v. *Group of Investors*, 335 U. S. 211, 227, *supra*; *Tagg Bros.* v. *United States*, 280 U. S. 420, 443–444; *Manufacturers Railway Co.* v. *United States*, 246 U. S. 457, 488–490.

As a general rule, of course, we believe the district court which receives an application under Section 11 (e) to enforce a plan approved by the Commission exercises a review function and must proceed on the basis of the administrative record.[62] However, there have been instances under the Holding Company Act, where, as in cases under Section 77, additional testimony has been taken to determine whether the case should be remanded to the Commission.[63] See *In re North-*

[62] In an oral opinion by Judge Biggs, sitting as a District Judge, *In the Matter of Midland United Corporation* (D. Del. 1944), and 11 (f) proceeding, he stated this rule as follows:

"I have also reached the conclusion that that adjudication must be based upon the entire record before the S. E. C. and on nothing more unless (a) it be shown that the situation of the debtor has so altered since the case was before the S. E. C. that it would be unfair and inequitable to proceed with the plan. * * * Or (b) where the S. E. C. has denied, or it is alleged that they have denied, due process of law in refusing to receive testimony or in denying a hearing. * * *"

See also *In re Jacksonville Gas Co.* (Unreported, D. Fla.), an 11 (e) proceeding quoted at R. 67.

[63] In an early proceeding in the Third Circuit where the Commission's order had been affirmed on review prior to its consideration in a Section 11 (e) enforcement proceeding, Judge Kirkpatrick held that the enforcement proceeding "is essentially a review proceeding." He noted that the specifications of the substantial evidence rule in Section 24 and the limitation of the Section 24 court's review to issues raised before the Commission "furnishes some basis for the argument that the scope of the hearing before this Court is broader." See *Application of Securities and Exchange Commission*, 50 F. Supp. 965 (D. Del.). It was held that the court could take evidence as to developments since the Commission acted but the particular proffer was rejected as irrelevant.

ern States Power Co. (unreported, August 30, 1948, D. Minn.) where additional evidence was received with reference to a contention, ultimately rejected by the Court, that the valuation data relied on by the Commission was stale.[9]

Whether the review function generally exercised by the district court should be based upon the substantial evidence rule or some other evidence weighing rule has been less sharply focused inasmuch as most of the controversies have turned upon issues of law. Nevertheless, both the First and Eight Circuits have given consideration to that issue and reached conclusions, contrary to that of the court below that the substantial evidence rule applies. *Lahti* v. *New England Power Association,* 160 F. 2d 845, 850 (C. C. A. 1); *In re Laclede Gas Light Company,* 57 F. Supp. 997 (E. D. Mo.), affirmed *sub nom. Massachusetts Mut. Life Ins. Co.* v. *S. E. C.,* 151 F. 2d 424 (C. C. A. 8), certiorari denied, 327 U. S. 795.

The district court's supervision of the execution of the plan also serves as a further safeguard

[9] In one case the district court received testimony, and on the basis thereof found unsubstantiated charges by a minority stockholder that the company which proposed the plan in question had been "coerced" by the Commission's staff. *In re United Gas Corp.,* 58 F. Supp. 501 (D. Del.), affirmed, 162 F. 2d 409 (C. C. A. 3). See also *In re Electric Bond and Share Co.,* 73 F. Supp. 426 (S. D. N. Y.), affirmed, 161 F. 2d 978 (C. C. A. 2), where it was charged that the objector had been deprived of due process of law in the administrative hearing.

against abuse of minority stockholders, the significance of which may depend on the nature of the plan; Section 11 (e) provides that "the court shall have jurisdiction to appoint a trustee," which could be the Commission, to "hold or administer, under the direction of the court and in accordance with the plan" the assets involved. Thus far, however, Section 11 (e) plans have not involved substantial discretion as to execution, and have been administered by corporate officers under the direction of the court.[65]

The above are examples of situation in which the district court acts independently and in other than a reviewing capacity. They leave ample room for the exercise of independent judgment without empowering the court to determine *de novo* matters of discretion or policy which the Commission has decided. As to such matters under Section 11 (e) as under Section 77, we submit the courts are not to overturn reasonable Commission findings.

C. *The issue of fairness in this case, if not a pure issue of law, falls within the area where finality attaches to the Commission's determination*

As we have previously argued, whether to reorganize on the basis of going concern values or

[65] It appears that Congress was concerned to safeguard against untimely dispositions if for any reason distribution in kind did not prove feasible and conceivably this might take place under Section 11 (e) plans as distinguished from

involuntary liquidation preferences seems to us to present an issue of law. If that issue in its present context is not already settled by the *Otis* case, we believe that this Court should now decide it as a matter of law. We do not ourselves urge the doctrine of administrative finality in support of the Commission's resolution of this issue.[55]

Addressing ourselves to the hypothesis, however, that the issue is one of discretion in the application of statutory policy, then we believe that discretion is lodged by the Act in the Commission and not in the district courts. The statutory policy emphasized by this Court in the *Otis* case, and upheld by the courts below as well as the Commission, is that the operation of Section 11 should not result in a shift of values from one class of security holders to another. If this policy is not to be effectuated intuitively on the basis of "colloquial equities", the controversy seems to relate primarily to whether inquiry should be confined to the operation of the particular plan before the Commission or should include a re-appraisal of all past transactions as if the Act had never been passed. While we have argued

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Section 11 (d) enforcement proceedings, or dispositions subject to Commission scrutiny under Section 11 (d). See Appendix B, p. 142.

[55] What the going concern value was would present a question of valuation as to which we believe the Commission's reasonable judgment would be binding. See *Western Pacific* case, *supra* p. 94). But the courts below did not disagree with the Commission as to this (R. 17).

that such a re-appraisal is, as a matter of law, inappropriate, we believe that the Commission, which has had to grapple with the past transactions and can best appraise the situation in relation to the over-all problem of achieving compliance with Section 11, is best equipped to decide whether the technique of retroactive revaluation is administratively feasible. As this Court has held, "the relation of remedy to policy is peculiarly a matter for administrative competence." See *Phelps Dodge Corporation* v. *N. L. R. B.*, 313 U. S. 177, 194.

Whether or not, as the Section 77 analogy indicates, the substantial evidence rule is generally applicable to the reexamination by a Section 11 (e) court of the prior determinations of the Commission, we believe that any policy functions which may have been delegated by the Congress are, because of their quasi-legislative character, inherently a function of the Commission rather than the courts. Exercise of such functions is subject to review for arbitrary or irrational exercise, but not because of judicial disagreement with policy determinations of the agency. See *National Broadcasting Co.* v. *United States*, 319 U. S. 190, 224, 225; *Federal Security Administrator* v. *Quaker Oats Co.*, 318 U. S. 218, 228; *Opp Cotton Mills* v. *Administrator*, 312 U. S. 126; *United States* v. *George S. Bush & Co.*, 310 U. S. 371; *American Tel. & Tel. Co.* v. *United States*, 299 U. S. 232; *Houston* v. *St. Louis Independent Packing Co.*,

249 U. S. 479; Final Rep. of the Att'y General's Comm. on Ad. Proc. 115–20.

The court below posed the issue of the scope of judicial review in terms of the applicability to the instant case of what this Court said in *S. E. C.* v. *Chenery Corp.*, 332 U. S. 194, 206–207, to the effect that unless the conclusions of the Commission lack "any rational and statutory foundation" they should not have been disturbed by the court below, for the "'fair and equitable' rule of Section 11 (e) * * * [was] inserted by the framers of the Act in order that the Commission might have broad powers to protect the various interests at stake * * * The very breadth of the statutory language precludes a reversal of the Commission's judgment save where it has plainly abused its discretion in these matters." This standard of review was rejected as inapplicable under 11 (e) because of the district judge's "independent" responsibility. (R. 31, 33.)

The point on which this Court divided in the *Chenery* case was whether the Commission was arbitrary, absent a prospective rule, in limiting to cost management purchases in the course of the reorganization, or whether within this area Congress had delegated to the Commission a discretion to proceed case by case as well as by rule. The Commission's decision was sustained as an authorized "judgment based upon public policy" (332 U. S. 194, 209). Once it be con-

cluded that a particular Commission decision does rest upon a policy judgment within an area delegated to it by the Congress, we believe it clear that neither a Section 24 court nor a Section 11 (e) court can have jurisdiction to set it aside."

While we believe the court below gave the wrong reason for rejecting the applicability of the *Chenery* case, acceptance of our main argument leads to the same conclusion. We believe the statute does not delegate to either Commission or the courts authority to exercise a policy judgment whether to accord security holders full compensation for rights surrendered. As to that the critical policy judgment has been made by the Congress in incorporating into Section 11 (e) the words of "fair and equitable." See *Case* v. *Los Angeles Lumber Products Co.*, 308 U. S. 106.

D. *To construe Section 11 (e) as conferring on the district court a valuation function coordinate with that of the Commission would make the statute unworkable.*

The opinion below states (R. 33–34):

> The court may not substitute its valuations for those of the Commission but it

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"Compare what was said in the first *Chenery* case, 318 U. S. 80, 94:

> "If the action rests upon an administrative determination—an exercise of judgment in an area which Congress has entrusted to the agency—of course it must not be set aside because the reviewing court might have made a different determination were it empowered to do so."

> may reject valuations made by the Commission. * * * The court of course may not act capriciously in rejecting valuations made by the Commission nor may the Commission act with caprice in valuing securities.

The decision of the court below remanding the case to the Commission contemplates that the Commission should exercise a fresh valuation function, taking into account the criticisms by the Court of Appeals of its initial valuation. As previously argued, we believe these criticisms raise issues of law and that this Court should resolve the question of law thereby posed. To the extent, however, that the opinion below rests upon the holding that the valuation function of the district court in the second instance is virtually coordinate with that of the Commission in the first instance, and that the district court's rejection of the Commission's valuation is upheld because the appellate court cannot hold the conclusion of the district judge "clearly erroneous" (R. 39), the ruling of the court below sets forth no controlling authority to govern the Commission upon remand. Instead, so long as there is no caprice in the difference of views between the Commission and the district court, each can thwart the other without there being any method of resolving conscientious disagreement as to what is "fair and equitable."

We believe that Congress could not have contemplated any such impasse, and that so to hold is to ignore the mandate of Section 1 (c) that all the provisions of the Act are to be interpreted "to meet the problems and eliminate the evils as enumerated * * * and to provide as soon as practicable for the elimination of public-utility holding companies except as otherwise expressly provided in this title." To avoid such a deadlock, we believe that, whatever authority the district court may have to check the Commission, its rulings as to what is "fair and equitable" should bind the Commission on remand. Conversely, the authority of the district court to reject the Commission's determinations should be no broader than its power to impose controlling directions on remand.[38]

[38] The opinion below recognizes that, the Engineers plan having been substantially executed, the only issue which could be open to the Commission on remand is how much, if any, of the escrowed cash goes to Engineers' preferred stock (R. 39, 40). Where a plan has not been executed at all the refusal of the district court to affirm because the Commission erred in determining the issue of fairness might warrant a reexamination of the type of plan. And, of course, we recognize that the Commission can have a new administrative function to perform in the determination of what is "fair and equitable" where the court's ruling is that the Commission did not properly discharge its administrative function. *Cf.* the first *Chenery* case, 318 U. S. 80.

It is likewise necessary in the interest of uniform administration of the statute, that in so far as the Commission's methods of valuation be rejected, the rejection not depend upon varying conceptions and discretion of individual district judges. This requires that where the district judge disagrees with the Commission his determinations not be binding on the appellate court unless "clearly erroneous" but be subject to full reexamination on appeal.

In suggesting that the district judge's disagreement with the Commission is not to be reversed unless "clearly erroneous" (R. 39), the court below refers to Rule 52 of the Rules of Civil Procedure. That rule, however, is concerned with due regard for the district judge's opportunity "to judge of the credibility of the witnesses," and appears to reflect primarily a policy of respecting the determinations of the initial trier of the facts. While the fact-finding function in connection with reorganizations is, of course, concerned more with the drawing of inferences than weighing credibility, we believe Rule 52 points more to the desirability of district judges upholding agency fact findings, than to their having an unreviewable discretion to disregard them.

CONCLUSION

Whether this Court agrees with the Commission that it applied a proper legal standard in valuing the preferreds or with the common stockholders that a proper legal standard requires the preferreds to be paid only their involuntary liquidation preference, we believe the plan need not be remanded to the Commission. Under either of these circumstances the Commission will have no further valuation function to perform.

However, if this Court agrees with the courts below that "colloquial equities" should be weighed by the Commission, it would be necessary to remand the proceedings for such a determination. Pursuant to such a remand the Commission would, of course, be confronted with a rather nebulous concept of equities to be weighed, and would have no guidance concerning the amount of weight to be attached to each of the equities considered unless the opinion of this Court should provide more specific criteria than does the opinion below. In the absence of such specific criteria we believe the opinion of the Commission already indicates that in its own judgment the weight to be attached to the equities mentioned by the courts below would not affect its valuation and consequently remand would serve no useful purpose.

For the reasons stated, we believe the court below should be reversed and the plan approved by the Commisson should be enforced.

Respectfully submitted.

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DECEMBER 1948.

APPENDIX A

Pertinent Provisions of the Public Utility Holding Company Act of 1935 and Section 77 of the Bankruptcy Act

Section 11 (e) of the Public Utility Holding Company Act of 1935 (49 Stat. 803, 15 U. S. C. 79 *et seq.*) provides as follows:

> (e) In accordance with such rules and regulations or order as the Commission may deem necessary or appropriate in the public interest or for the protection of investors or consumers, any registered holding company or any subsidiary company of a registered holding company may, at any time after January 1, 1936, submit a plan to the Commission for the divestment of control, securities, or other assets, or for other action by such company or any subsidiary company thereof for the purpose of enabling such company or any subsidiary company thereof to comply with the provisions of subsection (b). If, after notice and opportunity for hearing, the Commission shall find such plan, as submitted or as modified, necessary to effectuate the provisions of subsection (b) and fair and equitable to the persons affected by such plan, the Commission shall make an order approving such plan; and the Commission, at the request of the company, may apply to a court, in accordance with the provisions of subsection (f) of section 18, to enforce and carry out the terms and provisions of such plan. If, upon any such application, the court, after notice and opportunity for hearing, shall approve such plan as fair and equitable and as appropriate to effectuate the provisions of sec-

tion 11, the court as a court of equity may, to such extent as it deems necessary for the purpose of carrying out the terms and provisions of such plan, take exclusive jurisdiction and possession of the company or companies and the assets thereof, wherever located; and the court shall have jurisdiction to appoint a trustee, and the court may constitute and appoint the Commission as sole trustee, to hold or administer, under the direction of the court and in accordance with the plan theretofore approved by the court and the Commission, the assets so possessed.

Section 24 (a) of the same Act provides as follows:

SEC. 24. (a) Any person or party aggrieved by an order issued by the Commission under this title may obtain a review of such order in the circuit court of appeals of the United States within any circuit wherein such person resides or has his principal place of business, or in the United States Court of Appeals for the District of Columbia, by filing in such court, within sixty days after the entry of such order, a written petition praying that the order of the Commission be modified or set aside in whole or in part. A copy of such petition shall be forthwith served upon any member of the Commission, or upon any officer thereof designated by the Commission for that purpose, and thereupon the Commission shall certify and file in the court a transcript of the record upon which the order complained of was entered. Upon the filing of such transcript such court shall have exclusive jurisdiction to affirm, modify, or set aside such order, in whole or in part. No objection to the order of the

Commission shall be considered by the court unless such objection shall have been urged before the Commission or unless there were reasonable grounds for failure so to do. The findings of the Commission as to the facts, if supported by substantial evidence, shall be conclusive. If application is made to the court for leave to adduce additional evidence, and it is shown to the satisfaction of the court that such additional evidence is material and that there were reasonable grounds for failure to adduce such evidence in the proceeding before the Commission, the court may order such additional evidence to be taken before the Commission and to be adduced upon the hearing in such manner and upon such terms and conditions as to the court may seem proper. The Commission may modify its findings as to the facts by reason of the additional evidence so taken, and it shall file with the court such modified or new findings, which, if supported by substantial evidence, shall be conclusive, and its recommendation, if any, for the modification or setting aside of the original order. The judgment and decree of the court affirming, modifying, or setting aside, in whole or in part, any such order of the Commission shall be final, subject to review by the Supreme Court of the United States upon certiorari or certification as provided in sections 239 and 240 of the Judicial Code, as amended (U. S. C., title 28, secs. 346 and 347).

Section 77 (c) of the Bankruptcy Act (11 U. S. C. 205 (c)) provides as follows:

(c) Upon the certification of a plan by the Commission to the court, the court shall give due notice to all parties in interest of the time within which such parties may

file with the court their objections to such plan, and such parties shall file, within such time as may be fixed in said notice, detailed and specific objections in writing to the plan and their claims for equitable treatment. The judge shall, after notice in such manner as he may determine to the debtor, its trustee or trustees, stockholders, creditors, and the Commission, hear all parties in interest in support of, and in opposition to, such objections to the plan and such claims for equitable treatment. After such hearing, and without any hearing if no objections are filed, the judge shall approve the plan if satisfied that: (1) It complies with the provisions of subsection (b) of this section, is fair and equitable, affords due recognition to the rights of each class of creditors and stockholders, does not discriminate unfairly in favor of any class of creditors or stockholders, and will conform to the requirements of the law of the land regarding the participation of the various classes of creditors and stockholder; (2) the approximate amounts to be paid by the debtor, or by any corporation or corporations acquiring the debtor's assets, for expenses and fees incident to the reorganization, have been fully disclosed so far as they can be ascertained at the date of such hearing, are reasonable, are within such maximum limits as are fixed by the Commission, and are within such maximum limits to be subject to the approval of the judge; (3) the plan provides for the payment of all costs of administration and all other allowances made or to be made by the judge, except that allowances provided for in subsection (c), paragraph (12) of this section, may be paid in securities provided for in the

plan if those entitled thereto will accept such payment, and the judge is hereby given power to approve the same.

If the judge shall not approve the plan, he shall file an opinion, stating his conclusions and the reason therefor, and he shall enter an order in which he may either dismiss the proceedings, or in his discretion and on motion of any party in interest refer the proceedings back to the Commission for further action, in which event he shall transmit to the Commission a copy of any evidence received. If the proceedings are referred back to the Commission, it shall proceed to a reconsideration of the proceedings under the provisions of subsection (d) of this section. If the judge shall approve the plan, he shall file an opinion, stating his conclusions and the reasons therefor, and enter an order to that effect, and shall send a certified copy of such opinion and order to the Commission. The plan shall then be submitted by the Commission to the creditors of each class whose claims have been filed and allowed in accordance with the requirements of subsection (c) of this section, and to the stockholders of each class, and/or to the committees or other representatives thereof, for acceptance or rejection, within such time as the Commission shall specify, together with the report or reports of the Commission thereon or such a summarization thereof as the Commission may approve, and the opinion and order of the judge: *Provided*, That submission to any class of stockholders shall not be necessary if the Commission shall have found, and the judge shall have affirmed the finding, (a) that at the time of the finding the corporation is insolvent, or that at the time

of the finding the equity of such class of stockholders has no value, or that the plan provides for the payment in cash to such class of stockholders of an amount not less than the value of their equity, if any, or (b) that the interests of such class of stockholders will not be adversely and materially affected by the plan, or (c) that the debtor has pursuant to authorized corporate action accepted the plan and its stockholders are bound by such acceptance: *Provided further*, That submission to any class of creditors shall not be necessary if the Commission shall have found, and the judge shall have affirmed the finding, that the interests of such class of creditors will not be adversely and materially affected by the plan, or that at the time of the finding the interests of such class of creditors have no value, or that the plan provides for the payment in cash to such class of creditors of an amount not less than the value of their interests. For the purpose of this section the acceptance or rejection by any creditor or stockholder shall be in writing, executed by him or by his duly authorized attorney, committee, or representative. If the United States of America, or any agency thereof, or any corporation (other than the Reconstruction Finance Corporation) the majority of the stock of which is owned by the United States of America, is a creditor or stockholder, the interests or claims thereof shall be deemed to be affected by the plan, and the President of the United States, or any officer or agency he may designate, is hereby authorized to act in respect of the interests or claims of the United States or of such agency or other corporation.

The expense of such submission shall be certified by the Commission and shall be borne by the debtor's estate. The Commission shall certify to the judge the results of such submission.

Upon receipt of such certification, the judge shall confirm the plan if satisfied that it has been accepted by or on behalf of creditors of each class to which submission is required under this subsection holding more than two-thirds in amount of the total of the allowed claims of such class which have been reported in said submission as voting on said plan, and by or on behalf of stockholders of each class to which submission is required under this subsection holding more than two-thirds of the stock of such class which has been reported in said submission as voting on said plan; and that such acceptances have not been made or procured by any means forbidden by law; *Provided*, That, if the plan has not been so accepted by the creditors and stockholders, the judge may nevertheless confirm the plan if he is satisfied and finds, after hearing, that it makes adequate provision for fair and equitable treatment for the interests or claims of those rejecting it; that such rejection is not reasonably justified in the light of the respective rights and interests of those rejecting it and all the relevant facts; and that the plan conforms to the requirements of clauses (1) to (3), inclusive, of the first paragraph of this subsection: *Provided further*, That if in any reorganization proceeding under this section, the United States is a creditor on claims for taxes or customs duties (whether or not the United States has any other interest in, or claim against, the debtor, as creditor

or stockholder), no plan which does not provide for the payment thereof shall be confirmed by the judge except upon the acceptance, certified to the court, of a lesser amount by the President of the United States or the officer or agency designated by him pursuant to the provisions of the preceding paragraph hereof: *Provided further*, That if the President of the United States or such officer or agency shall fail to accept or reject such lesser amount for more than ninety days after receipt of written notice so to do from the court, accompanied by a certified copy of the plan, the consent of the United States insofar as its claims for taxes or customs duties are concerned shall be conclusively presumed. If the judge shall confirm the plan, he shall enter an order and file an opinion with a statement of his conclusions and his reasons therefor. If the judge shall not confirm the plan, he shall file an opinion, with a statement of his conclusions and his reasons therefor, and enter an order in which he shall either dismiss the proceedings, or, in his discretion and on the motion of any party in interest, refer the case back to the Commission for further proceedings, including the consideration of modifications of the plan or the proposal of new plans. In the event of such a reference back to the Commission, the proceedings with respect to any modified or new plan shall be governed by the provisions of this section in like manner as in an original proceeding hereunder.

If it shall be necessary to determine the value of any property for any purpose under this section, the Commission shall determine such value and certify the same to the court in its report on the plan. The

value of any property used in railroad operation shall be determined on a basis which will give due consideration to the earning power of the property, past, present, and prospective, and all other relevant facts. In determining such value only such effect shall be given to the present cost of reproduction new and less depreciation and original cost of the property, and the actual investment therein, as may be required under the law of the land, in light of its earning power and all other relevant facts.

APPENDIX B

EXTRACTS FROM THE LEGISLATIVE HISTORY OF SECTION 11

Extracts from S. Rep. 621, 74th Cong., 1st Sess., pp. 11–17:

4. SECTION 11.

As has been pointed out above, the purpose of section 11 is simply to provide a mechanism to create conditions under which effective Federal and State regulation will be possible. It is therefore the very heart of the title, the section most essential to the accomplishment of the purposes set forth in the President's message.

There has been much misunderstanding of the provisions of this section in the bill originally introduced (S. 1725). It has erroneously been called a "death sentence" upon all public-utility holding companies. It has erroneously been charged that it would confiscate the investment of the public in the utility industry. For these reasons particular explanation of this section appears in this report.

In its present form the section has been extensively rewritten. In general terms its purposes and effect can be stated substantially as follows:

(1) The "elimination" provided for in section 11, is simply a requirement that within 5 years (with certain permissible extensions) the presently existing public-utility holding companies must choose either—

(*a*) To turn themselves into investment trusts by making legal arrangements which

will deprive them of the control of the management of operating electric and gas companies in which they have investments, or

(*b*) To rearrange or reduce their holdings in operating companies, if necessary, so that each holding company will control the management of only a single system of operating companies, which single system is not mixed up with any extraneous businesses, such as real estate, hotels, and operations in foreign countries, and is either (*x*) predominantly intrastate, or (*y*) geographically and economically integrated in contiguous States, the laws of which will not permit merger into a single operating system.

(2) The title requires that a holding company be permitted to hold only a single system of operating companies in order to break down dangerous and unnecessary nation-wide financial interlockings in the essentially local operating utility business; to break down the concentration of the economic and political power now vested in the power trust; to reduce utility enterprises to a size and power which can successfully be regulated by local and Federal regulatory commissions; to rearrange the relationships between operating and holding companies on a functional basis so that intelligent regulation is possible; to confine the operations and the interest of each public utility system to the actual utility business of a given region so that the system will have to work out a modus vivendi with the population of that region.

Private utilities with their legalized monopolies are chartered to serve public ends. A far-flung disjointed system is independent and absentee so far as any partien-

lar community in its system is concerned. Its management has the problems of no one community for its exclusive consideration. It derives a great portion of its power and its profits from outside sources over which the community has no control. It can never be successfully regulated by the community it serves. It is a breeder of bad public relations.

An operating system whose management is confined in its interest, its energies, and its profits to the needs, the problems, and the service of one regional community is likely to serve that community better, to confine itself to the operating business, to be amenable to local regulation, to be attuned and responsible to the fair demands of the public, and more often to get along with the public to mutual advantage. A regional system, with each company confined to consolidation of its own territory, will offer no chance for the territorial raids at fantastic prices with which for 15 years competing holding company systems disturbed the operating business. Essentially local systems will tend to operate utilities rather than to play with high finance; and essentially local enterprise is far less likely to accumulate a disproportion amount of political and economic power.

All the advantages of large-scale operation and centralized financing claimed for present-day holding companies can be obtained when a holding company holds a single integrated system of operating companies or when a number of operating units are merged into the legal unit of a single large operating company.

Opponents of the title argue that a holding company should be permitted to hold more than one integrated system of operat-

ing companies because of the advantages of diversification of risk such a holding company can offer investors in its own securities. The answer to that argument is as follows:

(*a*) Experience has shown that there is no important actual diversification of economic risk either in the operations or the securities of present-day holding companies. The securities of those holding companies which claim to be most diversified have actually had the worst investment records; their own best securities are bonds secured by liens on specific operating properties. The argument of diversification of risk is an attempt to justify as a matter of economic principle, the accumulation of unrelated operating properties in a completely accidental way for immediate reasons of financial opportunism.

(*b*) Diversification of risk is a matter of investment judgment to be undertaken by the individual investor or an investment trust, not by those actually controlling and managing operating companies. "* * * The holding company in the past has confused the function of control and management with that of investment and in consequence has more frequently than not failed in both functions. * * * An investment company ceases to be an investment company when it embarks into business and management. Investment judgment requires the judicial appraisal of other people's management." (President's message of Mar. 12.)

(*c*) Even if the argument of diversification were sound, it is outweighed by the political and general economic desirability of breaking up concentrations of financial power in the utility field too big to be effec-

tively regulated in the interest of either the consumer or the investor and too big to permit the functioning of democratic institutions.

(3) A presently existing utility holding company can become an investment trust under the title by enfranchisement of independent holders of securities, by "sterilization" of a portion of the voting rights of the securities held by the holding company itself, by abandonment of proxy practices and interlocking directorates, or by divestment of a portion of holdings, etc., until it has satisfied the Securities and Exchange Commission that it has divested itself of control of the management of operating gas and electric companies. For many holding companies the simplest method may be the giving of voting rights to presently disfranchised independent holders of securities in operating companies in sufficient degree to satisfy the Securities and Exchange Commission that the holding company, despite its ownership of securities in operating companies, does not control the management of such companies.

(4) A presently existing utility, holding company with widely scattered holdings may continue to control the management of subsidiary operating utility companies if, within the period permitted by the section, it rearranges or reduces them to obtain a single integrated system.

(*a*) *Voluntary readjustment.*—Substantially such holding companies are given 5 years (with certain permissible extensions) in which to rearrange their affairs in their own way, on their own initiative, utilizing their present connections with investment banking houses for the flotation of new and refunding issues to buy and sell properties

and their present interrelationships with each other for the purpose of arranging exchanges of properties.

The Securities and Exchange Commission and the Federal Power Commission are expressly directed by the title to make a study of rearrangement possibilities to aid such rearrangement on a voluntary basis during the next 5 years. There has been a very pronounced voluntary movement on the part of the better companies in the last 10 years to dispose of outlying properties and to rearrange their properties into integrated systems. There are many forces at work in the industry which, given the machinery and the encouragement of legislation, will undertake to set their houses in order to enlighten self-interest in the same way that groups in the field covered by the Securities Exchange Act have undertaken reforms without compulsion within the framework of that act. Among those forces are new scientific developments, new distributions of financial power, the interests of investment banking houses in salvaging situations they have "sponsored", Government holdings of utility securities taken as collateral for Government loans, and the sheer necessity of reorganization, entirely independent of this title, in many holding company situations.

Section 11 provides that plans for the voluntary readjustment of the affairs of holding companies to conform with the section may be presented to the Federal courts at any time and that in such cases those courts may exercise in the furtherance of such voluntary plans all the extraordinary powers such courts have been accustomed to exercise when called upon under the Sher-

man and Hepburn Acts to effect compulsory corporate readjustments required by the public policy expressed in those acts.

The committee is of the opinion that careful consideration should be given to the advisability of amending the revenue acts to encourage voluntary corporate reorganization for the purposes of simplifying holding company structures, eliminating unnecessary complexities therein, and otherwise complying with the policies underlying holding company legislation. Such amendments should be considered not only in relation to the stamp and transfer taxes but to the income taxes as well. Naturally, any exemptions provided for these purposes should be limited to the needs of such purposes. The committee has taken no definite action on this matter because of the parliamentary procedure which may be construed to require such an amendment of the revenue act to originate in the House, but it definitely recommends concurrence by the Senate in any such amendment originating in the House.

With intelligent cooperation between the commissions, the Federal courts, Federal taxing policy, and the utility interests themselves, practically the entire operation of transformation and arrangement of those holding companies in which investors have anything left to save can be completed prior to the end of 5 years. Where the corporate structure of companies is simple, compliance with the bill will be comparatively simple. Where the corporate structure is complicated and confusing, as is the case with some holding companies, reorganization is inevitable irrespective of legislative compulsion.

(*b*) *Compulsory readjustment.*—In the case of those holding companies which at the end of the 5 years may not have completed for themselves the task of transformation into an investment trust or of rearrangement of their properties into a single integrated system, the Securities Commission is given power to take them into the Federal courts to require compliance with the title in one or the other way. The process of compulsory divestment of control is left to the Federal courts, without time limit, for the application of the technique worked out in the dissolutions under the Sherman Act and the Hepburn Act (commodities clause).

The title provides that during all court processes the Securities and Exchange Commission shall act as an impartial expert economic adviser and administrative assistant to the courts. That expert assistance will enable the courts to save time and expense in the solution of essentially economic and administrative problems for which in the Sherman Act cases it had no assistance except that of opposing counsel. But the courts can take such time as they deem advisable to dispose of assets without sacrifice.

Time taken in a dissolution proceeding should not injure the investor because the going-market prices of securities in the securities market anticipate in advance the break-up value which any particular security will have at the end of a dissolution proceeding. As a matter of fact, the valuation which the market places on holding companies securities today is but a rough calculation or prediction of the break-up value of an interest in the holding company's conglomeration of interests in op-

erating properties. During any process of reorganization under this title the market's appraisal of values is likely to be more accurate and reliable than at present because of the focusing of attention upon the down-to-the-rail assets which make up the real value of holding company securities.

(5) The reorganization of holding companies which are not necessary for the operation of geographically integrated operating systems will not adversely affect the credit of the utility industry.

(*a*) There may be some instances where the regional holding company, tying together small plants and small distributing areas, has in the past helped to draw capital into the actual industry. But the giant holding companies, by and large, have not drawn money into capital improvement and expansion of the industry but have utilized their investors' funds for the purchase of utility properties already built. Even after the holding company became a dominant factor in the utility industry, credit and investment were obtained for the industry directly through the operating companies rather than through the holding companies. It has been in the securities of the operating companies that insurance companies and savings banks have placed the bulk of their utility investments. They have wisely chosen the tested and secured obligations of the operating companies, and not the so-called "diversified securities" of the holding companies, based on slender and speculative equities.

The President pointed out in his radio address—

"Power production in this country is virtually back to the 1929 peak. The operating companies in the gas and electric utility

field are by and large in good condition but under holding company domination the utility industry has long been hopelessly at war with the industry and with public sentiment."

It is the existence of the unnecessary holding company and not the threat of its elimination that menaces the credit of the utility industry. The holding company advocates have spoken a great deal about the capital flowing into the utility industry while under the domination of the holding company. But they have made no effort to show how much of the investors' money used to purchase holding company securities ever went to build or improve utility properties. Dr. Harold G. Moulton, president of the Brookings Institution, in a recent book entitled "The Formation of Capital", states that very little of the money invested in holding-company securities went into productive capital. Moulton writes:

"The amount of securities floated by investment trust and public-utility holding companies in the years 1924 to 1930, inclusive, was as follows:

Year	Investment trusts	Public-utility holding companies	Year	Investment trusts	Public-utility holding companies
1924	$44,700,000	$246,300,000	1928	$1,026,000,000	$1,104,000,000
1925	208,500,000	401,900,000	1929	2,951,000,000	1,039,000,000
1926	96,600,000	532,900,000	1930	401,700,000	647,600,000
1927	418,700,000	883,500,000			

"Such issues served to confuse the true economic picture. They added to the volume of security offerings; but the funds procured were employed almost entirely in the purchase of corporate securities already outstanding. Instead of adding to productive capital, these financial operations merely served to multiply the number of

pieces of paper (shares of stock) constituting claims to existing properties. Ordinarily such a diluting process might be expected to depreciate the value of each piece of paper outstanding; but owing to the fact that the money was used mainly to buy existing securities it served instead to boost their prices."

The assertion that holding companies provide indispensable credit facilities for operating companies does not stand up against the statistical proof that the credit of operating companies in these days of depression—and depression days are the only true test of credit worthiness—is far better than the credit of holding companies. A recent report of the Federal Power Commission shows that the average quotations in November 1934, for 121 issues of operating company bonds listed as legal investments for trustees in the State of New York were 6.6 points higher than in September 1929. Recent prices have been even higher than those of last November. The selling prices of these investments, made solely on the credit of the operating company, contrast sharply with the low prices obtaining for holding company securities.

Before the House committee, Dr. David Friday, the economist for the utility interests, testified that with companies the size of Detroit Edison, Commonwealth Edison of Chicago, and Southern Edison of Los Angeles, "the holding companies are not necessary at all." According to this testimony, the supercredit and supermanagement of a holding company are not needed for companies in large cities. It is equally unnecessary to superimpose a giant holding company upon an economically integrated system of small plants which in the aggre-

gate afford the same conditions of self-sufficiency as the operating unit in the large city. Title I encourages the building up and strengthening of compact systems of related operating units even to the extent of providing exemption for a holding company if it is necessary for the functioning of such a system. Sound operating units or regionally integrated systems, not the giant holding companies, provide the real and only enduring basis of credit for the utility industry.

(*b*) An argument has been given widespread currency by the opponents of the title that the elimination of the giant holding companies will demoralize the market for all operating securities because many operating-company securities will be thrown upon the market by the giant holding companies in the course of their dissolution. The argument is premised on the false assumption that the proposed title will cause the dumping or forced liquidation of securities by the giant holding companies. As has been explained above, the title does not require the dumping or forced liquidation of securities. Such disposition as may be necessary can be accomplished by reorganization which will equitably redistribute securities among existing security holders. Insofar as there may be some redistribution of the securities of operating companies through investment banking channels, this will not result in a substantial net increase in the supply of utility securities on the market because for every block of operating securities distributed there will be a corresponding block of holding-company securities retired. The net effect of such changes will be to strengthen the market for utility securities

generally by replacing holding-company securities with sound operating-company securities. Such operations, primarily of a refunding nature, should strengthen rather than weaken the credit of operating companies.

The market for operating-company securities will be no longer adversely affected by the disrepute into which holding-company securities generally have fallen. The individual investor in present-day holding companies should come out of any reorganization process under the title with far better securities than those with which he went into it. He should get a security which represents an actual down-to-the-rails investment in a regulated local operating company, or, at most, a regulated regional holding company. He should get a security which will bring him, instead of paper stock dividends, all the legitimate cash dividends the operating company can pay—not what is left of them after high salaries, large fees, bonuses to holding-company officers and bankers, and the purchase of securities at exorbitant prices from corporate insiders. In short, the individual investor should receive the kind of a security he thought he was buying in the first place. The actual clearing up, through clean reorganizations, of the tangle in which holding-company finance has left the industry and those who have invested in it, can reestablish a confident, stable market for good utility securities. But a frightened policy of refusing to take hold of the obvious political and financial difficulties of the industry will only generate even greater future difficulties.

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Extracts from S. Rep. 621, 74th Cong., 1st Sess., pp. 32–34:

SECTION 11. SIMPLIFICATION, REORGANIZATION, AND DISSOLUTION OF HOLDING COMPANIES

Subsection (a) makes it the duty of the Commission to examine the corporate structure of every company in the holding company system of a registered holding company, the relationships among such companies, and the character of their interests and properties, to determine the extent to which unnecessary complexities may be removed, voting power fairly and equitably distributed among security holders, and the properties in a holding company system confined to those necessary or appropriate to the operations of a single geographically and economically integrated public utility system.

Subsection (b) makes it the duty of the Commission after notice and opportunity for hearing, (1) after January 1, 1938, (see subsection (c) below for possibility of extension), by order enforceable only in the Federal courts of equity, to require each registered holding company, and each subsidiary company thereof, to divest itself of any interest in or control over property or persons to the extent that the Commission finds necessary or appropriate to limit the operations of the holding company system of which such company is a part to a single geographically and economically integrated public utility system and to such business as is reasonably incidental or economically necessary or appropriate to the operations of such system; (2) after January 1, 1938 (with the same possibilities of extension) to require each registered hold-

ing company, and each subsidiary company thereof, to be reorganized or dissolved whenever the Commission finds that the corporate structure or continued existence of such company unduly or unnecessarily complicates the structure of the holding company of which it is a part, or unfairly or inequitably distributes voting power among the holders of securities, or is detrimental to the proper functioning of a single geographically and economically integrated public utility system; and (3) promptly after January 1, 1940, to require each registered holding company to take such steps as the Commission finds necessary or appropriate to make such company cease to be a holding company, except that the Commission is directed to permit a registered holding company to continue to be a holding company if such company obtains from the Federal Power Commission a certificate that the continuance of its holding company relation to subsidiaries is necessary, under the applicable State or foreign law, for the operation of a geographically and economically integrated public utility system serving an economic region in a single State or extending into two or more contiguous States or into a foreign country.

Subsection (c) provides that in any order under subsection (b) the Commission shall fix the time within which such order shall be complied with, not later than 1 year from the date of such order, but the Commission may, for good cause shown, extend such time for an additional period not exceeding 1 year.

The foregoing provisions are designed to produce a gradual and orderly elimination of the unnecessary utility holding com-

panies and the simplification of the capital structures and a fair distribution of voting power of those companies which are permitted to continue. Existing holding companies will be obliged (i) to divest themselves of any interest in properties not appropriate to a geographically and economically integrated public-utility system, or (ii) to cease to be holding companies by divesting themselves of all control over the public-utility companies in which they are interested and become investment companies, or (iii) to distribute their securities and assets equitably among their security holders. Precedents under the Sherman Antitrust Act and under the Hepburn Act demonstrate that the necessary corporate adjustments can be made without forced liquidation or the sacrifice of legitimate investment values.

Subsections (d), (e), and (f) outline the procedure whereby the reorganization plans must be approved by the Commission and carried out under the supervision of the Federal courts. The court is to take technical jurisdiction of the assets involved and appoint the Commission sole trustee or receiver to administer the assets as a trust estate for the benefit of the persons interested therein as their interests may appear. By these provisions it is intended to give the Commission the complete supervisory power which is essential to the elimination of the present wasteful practices in corporate reorganizations. It also ensures to investors that their properties will not be needlessly sacrificed but will be conserved by the Commission and the court until a satisfactory reorganization can be arranged. If a company is solvent, the court could continue the payment of

interest and in appropriate cases dividends until a prudent reorganization is effected. Subsection (e) expressly authorizes a holding company subject to the approval of the Commission and the court to work out a plan of reorganization to make unnecessary the issuance of an involuntary order for its reorganization by the Commission, and the Commission and the court are authorized to approve any plan so worked out voluntarily by a holding company as the Commission and the court might order under their compulsory powers. Thus the voluntary reorganizations of the holding companies might be facilitated by the recognized powers of a court of equity to make such equitable allocations of general liens and priorities as may be necessary to make it possible for the companies to comply with the policy of the statute (*Continental Insurance Co.* v. *U. S., Reading Co. et al.* 259 U. S. 156). If a company is insolvent or unable to pay its debts, the Commission is empowered by subsection (f) to institute proceedings for the reorganization of the company under section 77B of the Bankruptcy Act; in such proceedings also, the Commission could have itself appointed sole trustee. Under these subsections, Commission approval of reorganization plans and supervision of the conditions under which such plans are prepared will make it impossible for a group of favored insiders to continue their domination over inarticulate and helpless minorities, or even as is often the case, majorities. Fees, expenses, and remuneration paid in connection with any such reorganization, whether under section 77B of the Bankruptcy Act or otherwise, are

made subject to the approval of the Commission.

Subsection (g) makes it unlawful for any person to solicit any proxy, power of attorney, or deposit of securities for or against any reorganization plan, except under the following circumstances. The plan must either have been prepared by the Commission or submitted to it by a person having a bona fide interest in the reorganization. A copy of the report made by the Commission on the plan and other plans submitted to it or an abstract of such report approved by the Commission must accompany each such solicitation. The Commission may, by its rules, regulations, or orders, prescribe other terms of the solicitation which it considers necessary or appropriate in the public interest or for the protection of investors or consumers. It is expressly provided that no person shall be prevented from appearing before the Commission or any court through an attorney or proxy. This subsection is designed simply to assure that a security holder will have a fair opportunity to consider concrete proposals on their merits with full and fair disclosure of all material facts before he is pressed to register his vote on a reorganization plan or to tie himself irrevocably to a plan which in the future may develop to be unfavorable to him and to involve great expense on his part.

These provisions are framed to bring back to the investor such property interest as he may have in the underlying properties owned by the holding company. They destroy and confiscate no property, but they remove the confusing corporate devices and contrivances which have con-

fused the investor and in many cases have been used to deprive him of the fruits of his investment.

Extracts from Congressional Record, Vol. 79, 74th Cong., 1st Sess., pp. 8844–8845:

REGULATION OF PUBLIC-UTILITY HOLDING COMPANIES

The Senate resumed consideration of the bill (S. 2796) to provide for the control and elimination of public-utility holding companies operating, or marketing securities, in interstate and foreign commerce and through the mails, to regulate the transmission and sale of electric energy in interstate commerce, to amend the Federal Water Power Act, and for other purposes.

Mr. WHEELER. Referring now to page 49, I move to amend by striking out lines 8 to 25, inclusive, and substituting therefor the following.

The PRESIDENT pro tempore. The amendment will be stated.

The CHIEF CLERK. On page 49 it is proposed to strike out lines 8 to 25, both inclusive, and down to and including the word "appointed" in line 2, page 50, and to insert in lieu thereof the following:

"(f) In any proceeding in a court of the United States, whether under this section or otherwise, in which a receiver or trustee is appointed for any registered holding company or any subsidiary company thereof, the court shall have power, and, at the request of the Commission, it shall be the duty of the court to constitute and appoint the Commission as sole trustee or receiver subject to the direction

and orders of the court, whether or not a trustee or receiver shall heretofore have been appointed."

Mr. WHEELER. In other words, we greatly liberalize that section, because as it read before it provided that, if, in the judgment of the Commission, any registered holding company or any subsidiary company thereof was insolvent or unable to pay its debts, the Commission should have the power to institute proceedings for reorganization of such company under section 77B of the Bankruptcy Act. This amendment takes from the Commission the power to go into court and ask that a company be placed in the hands of a receiver because it is insolvent or because it cannot pay its debts. We simply say to the court now, "In the event you appoint a receiver, then upon the request of the Commission you shall appoint the Commission such receiver, but the Commission shall be subject to the rules and orders of the court."

The reason for these provisions is that it has been a notorious fact, as we all know, and as the Chairman of the Judiciary Committee [Mr. ASHURST] especially knows from his investigations, that a racket has existed in the matter of these receiverships. The section as amended, we believe, provides for the protection of investors in companies in the event they go into the hands of receivers—registered holding companies or their subsidiaries, companies which are engaged in interstate commerce—and only those companies—and that the Commission shall act as receiver and shall be subject to the direction and orders of the court.

Mr. BORAH. Mr. President——

The PRESIDENT pro tempore. Does the Senator from Montana yield to the Senator from Idaho?

Mr. WHEELER. I yield.

Mr. BORAH. I understand the sole effect of the amendment is to make it obligatory upon the court to appoint the Commission as trustee or receiver in case the court adjudges the parties bankrupt.

Mr. WHEELER. The purpose of the amendment is to make it clear that when the court appoints the Commission trustee or receiver, the Commission is to be subject always to the direction and orders of the court; and it is further designed to take away the power of the Commission to investigate bankruptcy proceedings under section 77B. The provision as it stands at the present time has been greatly criticized in some of the advertisements of some of the holding companies. They have held it out that what we were seeking to do was to take them over and have them condemned, thrown into receivership, and that the intention was to have the Government take them over. Of course, no such intention was in mind at all. All that was intended was exactly what we are doing here now for the protection of the investors. We have even taken from the Commission the right to go into court and ask that the company be placed in the hands of receivers. So that with this amendment, only if the court orders the company into receivership can the Commission ask that it shall be appointed as receiver or trustee.

Mr. HASTINGS. Mr. President, will the Senator from Montana yield?

Mr. WHEELER. I yield.

Mr. HASTINGS. My recollection of the section, without having read it for a day or

two, is that under the bill as reported by the committee the Commission itself could make application to the court if, in its judgment, any registered holding company or any subsidiary company thereof was insolvent or unable to pay its debts?

Mr. WHEELER. That is correct.

Mr. HASTINGS. Then the bill provided that, having made the application to the court, the court was compelled to appoint the Commission trustee, and then that there could be no reorganization except the kind of reorganization suggested by the Commission itself. In other words, under the bill we have the Commission itself, which has no monetary interest in the matter, and which makes application for the bankruptcy proceeding, given power to have itself appointed trustee and then itself propose the plan of reorganization. I should like to know what changes the amendment makes in those three respects?

Mr. WHEELER. The amendment completely changes the first of those three things, because, in the first place, it takes away from the Commission the right to go into court and ask the court to appoint a receiver.

Mr. HASTINGS. That is the important matter.

Mr. WHEELER. Yes. As I say, the provision was not intended as it has been interpreted; but I can readily understand how, in view of the language, it might raise a fear in the minds of some people, and they might say, "The Commission may throw us into receivership and be appointed receiver, and then have a reorganization plan", and so forth. They might say, "It is an inducement for the Commission to throw us into the hands of a re-

ceiver"; but the Senator from Delaware will agree with me that this language changes the whole situation.

Mr. HASTINGS. Of course it is a little difficult to follow the language and remember it when one has not the amendment before him; but let me make an inquiry. The Senator says the amendment removes the first objection, which I think was the most serious one.

Mr. WHEELER. Absolutely.

Mr. HASTINGS. Does the amendment leave the other two provisions? As I remember, the Senator said it does provide that the Commission shall be named trustee or receiver by the court.

Mr. WHEELER. That is correct.

Mr. HASTINGS. Does it in any way affect the persons who may suggest the plan of reorganization?

Mr. WHEELER. No. I will say to the Senator from Delaware that another Senator is talking to me about that subject, and we are trying to work out an amendment. On that last point of who may suggest the plan of reorganization, section 11 is quite clear that the suggestion may come from any interested person. It is not limited to the Commission's own plan, so long as the plan is eventually approved by the Commission. All we are seeking to do in this whole section is to protect persons who have invested their money from a racketeering receivership, such as the Senator well knows has taken place in many cases throughout the country, and particularly as was investigated by the Judiciary Committee of this body, under the leadership of the Senator from Arizona [Mr. ASHURST].

The PRESIDENT pro tempore. The ques-

tion is on agreeing to the amendment offered by the Senator from Montana.

The amendment was agreed to.

Mr. BORAH. Mr. President, I desire to ask the Senator from Montana a question.

On page 50, beginning with line 2, the bill provides as follows:

"In any such proceeding a reorganization plan for a registered holding company or any subsidiary company thereof shall not become effective unless such plan shall have been approved by the Commission after opportunity for hearing prior to its submission to the court."

I do not exactly understand that language. Does it mean that the court's jurisdiction with reference to the reorganization, or what shall be permitted by decree of the court, is limited; or is it simply recommendatory to the court?

Mr. WHEELER. We do exactly the same thing at the present time, as I understand, with reference to the Interstate Commerce Commission. A plan for the reorganization of a railroad is supposed to be submitted to the Interstate Commerce Commission for its approval before it is approved by the court. We put this provision in here in practically the same manner, as I recall, as the existing provision with reference to the Interstate Commerce Commission in the case of railroad reorganizations.

Mr. HASTINGS. Mr. President, in that connection, if it be true that no reorganization plan can be considered except that which is suggested by the Commission, why is it necessary to put in the language "Shall not become effective unless such plan shall have been approved by the Commission after opportunity for hearing prior to its submission to the court"? My understand-

ing is that the Commission is the only body which can submit a reorganization plan.

Mr. WHEELER. Oh, no; the Senator is wrong about that.

Mr. HASTINGS. A plan may be submitted by somebody else?

Mr. WHEELER. Absolutely. The Commission may submit a plan if it sees fit to do so, or some private individual may submit a plan; but the idea is that if some private individual submits a plan, exactly as in the case of railroad receiverships at the present time, it shall first be approved by the Commission.

Mr. STEIWER. Mr. President, will the Senator yield?

Mr. WHEELER. I yield.

Mr. STEIWER. In respect to the language which is now under discussion, at the top of page 50, has there been urged upon the committee, or brought to the attention of the chairman, the contention that that language would oust the court of its jurisdiction, and, therefore, be objectionable?

Mr. WHEELER. To what language does the Senator refer?

Mr. STEIWER. The language to which the Senator from Idaho [Mr. Borah] has just called attention, near the top of page 50.

Mr. WHEELER. No; I do not think it would oust the jurisdiction of the court. I think there is no question that Congress would have the power to say that the court shall, when it appoints a receiver, appoint the Commission receiver, because, after all, the court is a statutory court, and we have the right to say that before this plan is approved by the court it shall be approved by the Commission. Furthermore, this is a mere matter of Congress providing the administrative machinery surrounding re-

ceiverships, and in no way usurping any judicial powers. The judicial functions remain, as always, in the court.

If I am not mistaken about the matter, we employ exactly that procedure in railroad reorganizations at the present time; and the only complaint we have had has been that the Interstate Commerce Commission has been too lenient, and has approved a number of plans which should not have been approved.

Mr. STEIWER. I make no contention about the matter at this time, but it occurs to me that provision might be subject to the objection that it would oust the jurisdiction of the court.

Mr. WHEELER. The Senator from Indiana [Mr. Minton] has called my attention to the fact that the provision does not oust the jurisdiction of the court at all, because the court has to approve the plan even though the Commission approves it. In other words there is really a double check upon the plan, and final determination rests as in the past in the courts.

Extracts from Congressional Record, Vol. 79, 74th Cong., 1st Sess., pp. 8936–8941:

Mr. MCKELLAR. Mr. President, I have another amendment which I do not believe we have entirely agreed upon.

On page 52 of the reprint of the bill, beginning at line 12, subsection (f), the language has been amended to read as follows:

"In any proceeding in a court of the United States, whether under this section or otherwise, in which a receiver or trustee is appointed for any registered holding company, or any subsidary company thereof"—

And I call especial attention to the language I am now going to read—

"the court shall have power, and, at the request of the Commission, it shall be the duty of the court, to constitute and appoint the Commission as sole trustee or receiver, subject to the directions and orders of the court."

That language is an improvement on the language of the original bill; but I desire to suggest to the chairman of the committee that in lines 15, 16, and 17 the words "shall have power, and, at the request of the Commission, it shall be the duty of the court to" be stricken out, and the word "may" inserted, so that, if amended, it will read as follows:

"In any proceeding in a court of the United States, whether under this section or otherwise, in which a receiver or trustee is appointed for any registered holding company, or any subsidiary company thereof, the court may constitute and appoint the Commission as sole trustee or receiver, subject to the directions and orders of the court."

I offer that amendment, Mr. President. I hope the Senator from Montana will accept it; and I will say to him that I should then be perfectly willing to offer the suggested amendment which the Senator handed me a few moments ago, which would accord with the words I have just offered.

Mr. WHEELER. Mr. President, let me say to the Senator from Tennessee, referring to his tendered amendment, that the purpose of the amendment on page 52 as it stands at the present time is to do just exactly what the Senator from Maryland [Mr. Tydings] a moment ago said should

be done; that is, that in this bill we should do everything possible to protect investors under a reorganization plan.

When a reorganization plan is offered, if the utilities can go to some one of the Federal judges and pick out a receiver or a trustee who is friendly to them, they can perpetrate a fraud and a racket upon the investor.

I appreciate the fact that the Senator from Tennessee is absolutely in sympathy with the purpose expressed in this bill; and, as I understand, the only thing the Senator is afraid of is that the court may say, "I have the power and the right to appoint anybody. I wish to appoint as receiver or trustee, and the Congress of the United States has not any right to limit my discretion in appointing a trustee or receiver."

Remember that under the language of the bill we say that the Commission shall be appointed. Of course, that means that when the Commission shall be appointed receiver, it will pick out either one of its members or some one of its officers to administer the trusteeship or receivership.

Mr. CLARK. Mr. President, will the Senator from Tennessee yield to me for the purpose of asking a question?

Mr. MCKELLAR. Yes; I yield to the Senator from Missouri.

Mr. CLARK. Does the Senator from Montana know any reason on earth why Federal Commissioners appointed by the President and confirmed by the Senate necessarily have a higher standard of honor, or a higher standard of any sort, than a Federal judge appointed by the President and confirmed by the Senate?

I must say to the Senator from Montana that I cannot go along with him in

this statement that somebody may sneak in to one of the Federal judges. Somebody is just as likely to sneak in to a member of the Federal Securities Commission.

Mr. MCKELLAR. Mr. President, I understand and fully appreciate the argument of the Senator from Missouri; but that is not exactly the matter to which I am attempting to direct my remarks. Here we have a nominal jurisdiction granted to the court to appoint a receiver, but actually the Commission can appoint whomsoever it pleases. If this language, "shall have power, and, at the request of the Commission, it shall be the duty of the court, to" be stricken out, and the word "may" inserted in lieu thereof, I have no doubt in the world that the court will invariably confer with the Commission before it makes an appointment.

I desire to say to the Senator from Montana that, in my judgment, if he attempts to give authority to the Commission to appoint the trustee, or to appoint itself trustee, while ostensibly giving that authority to the court, it is sure to bring about trouble. I really believe the Senator from Montana will make a great mistake if he does not accept language that will bring about a reasonable settlement of this matter in conformity with the well-known principles of law and practice in such cases.

I do not agree with the Senator from Montana that Federal judges are dishonest or corrupt. If they appointed somebody in the interest of these companies, they would be acting fraudulently and corruptly. So far as I am concerned, I am a great believer in the court; and I think it is most essential to leave this provision

in the nature of an advice or a direction to the court, but not make it the duty of the court to appoint the Commission. By the way, I think the paragraph would be very much stronger if it provided for the appointment of some member of the Commission. When the Commission itself is appointed, it may mean the office boy, or it may mean a member of the Commission. We do not know who it will be. It is a "cat in a bag."

Mr. CLARK. Mr. President, will the Senator yield?

Mr. MCKELLAR. Yes; I yield.

Mr. CLARK. The principle of the bill is not to vest any discretion in the Federal courts, but to vest every and any sort of discretion in the Securities Commission.

Mr. MCKELLAR. The Members of the Senate, in view of their recent experience, ought to know that it is a dangerous thing for one branch of the Government to trespass upon the rights of another branch.

Mr. BARKLEY. Mr. President, will the Senator yield?

Mr. MCKELLAR. Yes; I yield.

Mr. BARKLEY. I appreciate the force of what the Senator says. Of course, this is an administrative duty of the court. It is not like telling the court how to decide the law, or as to equities among investors, or how a reorganization shall be brought about. The appointment of receivers is an administrative matter which is performed by courts.

Mr. MCKELLAR. Why not take away from the courts the right to appoint a receiver and vest it in the Commission?

Mr. BARKLEY. I think Congress has the power to direct a court which is its creature

with respect to the appointment of receivers.

Mr. CLARK. Mr. President, if the Senator will yield——

Mr. BARKLEY. Just a moment. Another thing that enters into the matter is, to avoid, as the Senator from Montana has repeatedly said, the appointment of outsiders, or insiders, as a matter of fact; and that is no reflection on the integrity of the court. We all know how frequently these things come about. Application is made to the court for the appointment of a receiver or a trustee——

The PRESIDENT pro tempore. The time of the Senator from Tennessee on the amendment has expired.

Mr. CLARK. Mr. President, I claim the floor in my own right on the amendment.

The PRESIDENT pro tempore. The Senator from Missouri is recognized on the amendment.

Mr. CLARK. I should like to reply to what the Senator from Kentucky has said, if the Senator from Tennessee will permit me to do so.

Mr. MCKELLAR. I shall be very glad to have the Senator do so.

Mr. CLARK. Then I shall be very happy to permit the Senator from Tennessee to consume the rest of my time, because I have been trespassing on his time.

I think the Senator from Kentucky has misstated the theory of a receivership. The theory of a receivership is that the insolvent property is intrusted to the jurisdiction of the judge, the head of the judicial system in that jurisdiction.

Mr. MCKELLAR. Mr. President, will the Senator yield?

Mr. CLARK. I yield.

Mr. MCKELLAR. I imagine the framing of this particular language was brought about—indeed, I am rather inclined to think the chairman of the committee told me it was—because of many scandals in the appointment of receivers. We all know that that has taken place; but with this language changed as I propose to change it, a repetition of such scandals would be almost impossible.

Mr. CLARK. Mr. President, if the language which the Senator has proposed to insert in the bill is offered as a result of just criticisms or unjust criticisms of Federal receiverships, the remedy is to change the law, and, if necessary, to change the Constitution so as to make it easier to impeach or to remove Federal judges who misuse their offices.

The whole theory of a receivership is that the insolvent estate is put into the hands of a judge; and when a receiver is appointed, according to the theory of the law as it has always been up to the time this particular measure came along, the theory has been that the receiver was merely the agent of the court, for whom the court was responsible, over whom the court exercised the ultimate control; and we all know that judges have been impeached, and once in a while a judge has been convicted, because of the acts of his receivers.

Mr. MINTON. Mr. President, will the Senator yield?

Mr. CLARK. In just a moment. This proposition, Mr. President, is simply to restrain the discretion of the judge, as the Senator from Kentucky [Mr. BARKLEY] very well said, to make his office a mere administrative one, removing all responsibility whatever from the judge.

Mr. BARKLEY. Mr. President, if the Senator will yield, let me say that the bill does not do that.

Mr. CLARK. Mr. President, I insist that it does do that. I shall be glad to yield to the Senator from Kentucky in just a moment. I wish, first, to finish this thought.

This proposition is to do away with the whole principle of agency of the court, which the whole receivership theory has always been.

Now I yield to the Senator from Kentucky.

Mr. BARKLEY. The language which has been included in the amendment of the Senator from Montana negatives the very suggestion, because, after the appointment of the Commission as receiver, it is subject to the directions and orders of the court.

Mr. CLARK. In other words, Congress is to appoint an agent and then hold the Federal court responsible for the acts of the agent. This is the Senator's proposition, as I understand. I agree with the Senator from Tennessee that the present form of the section is a very great improvement over the original section.

Mr. MCKELLAR. There is no question about it.

Mr. CLARK. But the Senator wants a Federal judge to appoint an agent, and he may be any agent the Commission may nominate. He may be the office boy, as the Senator from Tennessee said, or he may be any sort of a young lawyer. The court appoints the Commission, and then the Commission sends out an emissary to act as its agent.

Mr. WHEELER. Mr. President, will the Senator yield?

Mr. CLARK. I yield.

Mr. WHEELER. Let me say to the Senator that this does not change the bill in any way. There is a precedent for it at the present time in a law which was enacted during a recent session of the Congress. In applying the rule to the reorganization of railroads, we provided that when a petition was filed with the Federal court, the court should make a selection from a panel. We did not provide that he had to appoint a receiver, but that if he appointed a receiver he had to make his selection from a panel furnished him.

Mr. CLARK. I am very familiar with that act, and I have very grave doubt as to its constitutionality, so far as any compulsion on a judge to select a trustee from a panel is concerned. Nevertheless, that is essentially a different proposition from the one before us.

Mr. WHEELER. The same principle applies, for the reason that these courts are statutory courts. When the Senator talks of its constitutionality, I reply that there cannot be any question as to its constitutionality.

Mr. MCKELLAR. I am not sure that the Senator is right about that.

Mr. WHEELER. There is no question about the constitutionality of it. There may be some question about the wisdom of the policy.

Mr. CLARK. I did not say a word about the constitutionality. The Senator is putting words into my mouth which I did not use. I said I had very grave doubt as to whether the act to which the Senator referred, compelling a Federal judge to appoint trustees from a particular panel, is constitutional; and I do have grave doubts

as to its constitutionality. That is essentially a different proposition, and entirely immaterial to the argument now being made.

Mr. WHEELER. These courts are constitutional courts. The only jurisdiction they have is what the Congress of the United States has granted them, and one of the powers Congress has granted to these judges is, under the equity procedure, to appoint trustees and receivers under certain circumstances. If we have the power to give them that authority we have the power to limit their jurisdiction with reference to it.

I myself felt that the bill as it originally came before us, where it provided that the Commission could throw companies into bankruptcy, was too broad, and I worked out with the Senator from North Carolina [Mr. BAILEY] an amendment, which was offered and which has been adopted.

Mr. CLARK. That amendment has been adopted?

Mr. WHEELER. Yes.

Mr. MCKELLAR. There is an amendment to the amendment here.

Mr. WHEELER. An amendment has been adopted which the Senator from North Carolina and I worked out. I have no interest in the matter, and nobody else has, except that, so far as it is humanly possible, we want to protect the investors who, the utility people say, will be ruined. I know, as a matter of fact, that one of these companies which has been one of the worst in the United States will probably apply to the courts in a very short time for a receivership or trusteeship for the purpose of reorganizing, because it is in such shape that that must be done. I know just as well as

that I am standing here that if that is done they expect to go into the Federal court and undertake to have trustees and receivers appointed, and without casting any reflection upon any court, we do not need to do that. The Senate of the United States, under the leadership of the Chairman of the Judiciary Committee of the Senate, has been investigating receiverships from one end of the country to the other, and every Member of the Senate who has followed the investigation knows that there has been wide-spread scandal.

Mr. CLARK. Mr. President, as the Senator knows I am not in agreement with a great many things which have happened in connection with the Federal courts; but I emphatically and violently disagree with the Senator from Montana in his belief that a commission set up in Washington is necessarily infallible, and will always be pure, and will always be superior to the wisdom of any Federal judge.

A few years ago, during the administration of the late President Wilson, the Federal Trade Commission was set up. The original personnel of that Commission was particularly designed and appointed for the purpose of carrying out the purposes of the Federal Trade Commission Act. In fact, several members of the Commission first appointed to the Commission had participated in the drawing of the act. As I understand, it is contemplated that if the measure before us shall be enacted, some of the men who have participated in drafting it will be appointed on the Securities Commission, which up to date has done exceedingly well.

President Wilson died; the party which sponsored the Federal Trade Commission

Act was defeated and driven from power, and one of the first acts of President Harding was to appoint on the Federal Trade Commission Mr. William E. Humphrey. I do not wish to reflect on Mr. Humphrey, who is dead. As a matter of fact, he was a personal friend of mine in his lifetime, when he served in the House of Representatives. But his whole conception and his whole idea of the function of the Federal Trade Commission was diametrically opposite to that of the President who had recommended the establishment of the Federal Trade Commission, and the Representatives and Senators who had led the fight for its creation. He proceeded completely to reverse the whole theory of the function of the Federal Trade Commission.

I see a man in the press gallery at this moment who took an interview from Mr. Humphrey in which Mr. Humphrey specifically said, "What the hell do you think I was appointed for?" In other words, he was appointed for the sole purpose of reversing the entire intent and purpose of the Federal Trade Commission Act.

I say that I very violently disagree with the theory of the Senator from Montana and of the other sponsors of the bill that any sort of a commission functioning from Washington, through emissaries, or agents, or attorneys, is to be preferred in its discretion to a Federal judge, appointed to one of the very highest honors in this country, appointed by the President usually after careful and most meticulous selection, and confirmed by the United States Senate.

Mr. McKellar. Mr. President, will the Senator yield?

Mr. Clark. I yield.

Mr. McKELLAR. In line with what the Senator is saying, I should like to repeat something I think I mentioned on the floor of the Senate the other day: The representative of a commission now in existence in Washington came to the Capitol to see about a bill being considered before the Committee on Post Offices and Post Roads, of which I am chairman, and he brought with him a man who had charge of the particular department concerned with the bill. From the way he acted and from what he said I judged that the latter gentleman was not connected with the commission at all, but represented the companies which were interested.

The PRESIDING OFFICER (Mr. Hatch in the chair). The Senator from Tennessee has already exhausted his time.

Mr. McKELLAR. I am speaking in the time of the Senator from Missouri.

The PRESIDING OFFICER. The Senator from Missouri has also exhausted his time.

Mr. McKELLAR. Then I will speak in my own right.

The PRESIDING OFFICER. The Senator's time has expired.

Mr. McKELLAR. I have time on the bill.

The PRESIDING OFFICER. The Senator from Tennessee is recognized on the bill.

Mr. HASTINGS. Mr. President, will the Senator yield?

Mr. McKELLAR. I yield.

Mr. HASTINGS. Let me call the attention of the Senator from Tennessee to the last four lines of paragraph (f), which we are now discussing, in response to the suggestion that the Commission is to be appointed receiver because of the bad conditions which have been developed in connection with the appointment of receivers. Most

of those criticisms are due to the compensation allowed receivers. But in the very bill before us it is provided that the Commission shall be entitled to such reasonable compensation for its services as trustee or receiver in any proceeding as the court may allow. I should like to inquire how that relieves us under any condition of the trouble we have experienced in the past.

Mr. McKELLAR. Mr. President, I may say that I hope to have those lines stricken out, because I think that is an open invitation to bring about the very state of scandal of which the Senator from Montana, the chairman of the committee, spoke a few moments ago, and I do not think such a provision ought to be in the bill.

Mr. GORE and Mr. CLARK addressed the Chair.

The PRESIDING OFFICER. Does the Senator from Tennessee yield; and if so, to whom?

Mr. McKELLAR. I yield first to the Senator from Oklahoma.

Mr. GORE. I rose to say to the Senator from Delaware that I intend to move to strike out the language to which he has referred and the whole provision. I think it would be a nest of scandal and ought not to be in the law.

Mr. CLARK. If those lines remain in the bill, would not the language authorize any Federal judge who happened to be particularly amenable to Federal influence to mulct the stockholders or the security holders of any of these companies in any sum that a commission might wish to pay any agent who was sent out?

Mr. McKELLAR. I think the language is very unfortunate, and I very much hope the chairman of the committee will be

willing, as I believe he will be, to strike it out.

Mr. WHEELER. Mr. President, will the Senator yield to me?

Mr. MCKELLAR. I yield.

Mr. WHEELER. I was interrupted, but I believe the Senator was referring to the compensation feature.

Mr. MCKELLAR. Yes; as provided on page 57.

Mr. WHEELER. The intention was not to provide for the payment of compensation but for the payment of expenses. The Senator from Oklahoma [Mr. GORE] called my attention to it, and I said to the Senator from Oklahoma that I thought the most the commission ought to be paid was simply the actual expenses they incurred.

Mr. CLARK. Will the Senator from Tennessee yield?

Mr. MCKELLAR. I yield.

Mr. CLARK. If the Commission should choose to appoint a lawyer and pay him $100,000 a year to act as attorney for the Commission in the receivership of some company, and the court chose to approve it, that would bring back every vicious practice that has ever been complained of and many more.

Mr. MCKELLAR. I agree with the Senator from Missouri entirely. I think it would invite trouble of the kind which it is desired to avoid, and I am quite sure, knowing the chairman of the committee as I do, that he will not insist on that language remaining in the bill.

Mr. WHEELER. If it is desired to strike out the words "The commission shall be entitled to such reasonable compensation for its services as trustee or receiver in any proceeding as the court may allow",

I am quite willing to have them stricken out.

Mr. McKELLAR. I move that the language in lines 15, 16, 17, and 18 on page 53 of the bill be stricken out.

Mr. BARKLEY. Mr. President, there is an amendment pending. Another cannot be offered until the pending amendment shall have been acted upon.

Mr. GORE. I wish to express my hearty concurrence in that amendment. I had intended to make that motion. I discussed this matter with the chairman of the committee last week, and he indicated not only a willingness but a desire that this language should be modified, and that nothing more than expenses should be allowed. I think even expenses should be limited.

Mr. WHEELER. Has that motion been acted on?

Mr. McKELLAR. It has not been acted on.

The PRESIDING OFFICER. The parliamentary situation is as follows: There is pending an amendment offered by he Senator from Tennessee which has not been acted on.

Mr. McKELLAR. If it is not in order, I ask to withdraw my previous amendment.

The PRESIDING OFFICER. Without objection, the amendment is withdrawn.

Mr. McKELLAR. I now wish to say to the chairman of the committee and to the Senate that I am very anxious to vote for this bill, but I am also anxious that it be a constitutional measure. I have talked it over with the Senator from Montana a number of times. The language on page 52 which I ask to have stricken out is as follows:

"The court shall have power, and, at the request of the Commission, it shall be

the duty of the court, to constitute and appoint the Commission as sole trustee or receiver."

I think that language ought to be eliminated. The courts are going to construe this bill; the courts are going to determine what this bill means; and we are here saying to the courts, "We have no confidence in you. Ordinarily it is true you appoint receivers, but we are going to take this power away from you. We are going to invade your province and take this power away from you." I do not think we ought to pass such legislation. I do not think by this bill we ought to slap the courts in the face.

I believe in courts. Sometimes they do wrong, of course; they sometimes fail to do what they ought to do. They are not perfect; but neither are commissions perfect. From my experience with commissions and with courts, I believe I would rather trust the courts.

Mr. WHEELER. What the Senator wants to do is to strike out the language:

"The court shall have power, and at the request of the Commission, it shall be the duty of the court"—

And so forth?

Mr. MCKELLAR. And insert the word "may", so as to indicate that is what Congress wants to be done, but not control the court or undertake to control the court.

Mr. WHEELER. I will be willing to take that language to conference.

Mr. MCKELLAR. I thank the Senator, and I hope the amendment will now be voted on, and then I will offer the amendment which I have just withdrawn.

Mr. GORE. Mr. President, I wish to suggest an amendment which I think the Senator from Tennessee will accept.

Mr. MCKELLAR. Is that with reference to the pending amendment striking out the language I have just indicated?

Mr. GORE. No.

Mr. MCKELLAR. Will the Senator let that amendment be voted on first?

Mr. GORE. I wish to insert the words, "The Commission or any member thereof."

The PRESIDING OFFICER. The pending amendment will be stated.

The CHIEF CLERK. In the original copy or print of the bill——

Mr. CLARK. Mr. President, which is the original copy? We have had so many copies of this bill that it is difficult to know just what copy is being referred to.

Mr. MCKELLAR. Let us have the language stated, and then we will know which copy is being used.

The CHIEF CLERK. On page 50——

Mr. CLARK. Mr. President, is the clerk reading from the original copy, S. 2796, or the reprint?

Mr. WHEELER. The clerk is reading from the original bill.

The PRESIDING OFFICER. The bill before the Senate is S. 2796, reported May 13, calendar day May 14, 1935.

Mr. MCKELLAR. If the clerk will read the language, I am quite sure we will be able to tell from which copy of the bill he is reading.

The CHIEF CLERK. On page 50, line 22, it is proposed to strike out—

"The Commission shall be entitled to such reasonable compensation for its services as trustee or receiver in any proceeding as the court may allow."

Mr. CLARK. I suggest to the Senator from Tennessee that the language of that entire section has been somewhat changed by the latest amendment.

Mr. BARKLEY. Mr. President, we are dealing with the original bill without these italicized amendments. They were printed for the convenience of Senators, but in the RECORD we are considering the original bill.

Mr. CLARK. Mr. President, a parliamentary inquiry.

The PRESIDING OFFICER. The Senator will state it.

Mr. CLARK. Do I understand on page 52 of the latest print the language in italics—

"In any proceeding in a court of the United States, whether under this section or otherwise"—

and so forth, has not been adopted by the Senate?

Mr. BARKLEY. It has been adopted. We agreed Friday to print the amendments in the bill which had been adopted, so that Members could see what had been acted upon, but in the consideration of the bill as a matter of record for the Journal we must consider, I suppose, the original bill, and the changes in it, without regard to these amendments.

Mr. MCKELLAR. In order to obviate that difficulty, if the Senator from Missouri will let us vote on the motion to strike out the language referred to on page 53, then I will ask for a reconsideration so we can vote on the other amendments.

Mr. WHEELER. Mr. President, I wish to address myself to the Senator from Tennessee [Mr. MCKELLAR] and the Senator from Missouri [Mr. CLARK]. If this language is changed to "may" and is agreed to, would the Senator have any objection

to putting in the bill a provision—this language was just called to my attention by the Senator from Washington [Mr. SCHWELLENBACH]—to the effect—

"*Provided*, That before the court shall appoint any receiver, or trustee it shall notify the Commission of the fact that it is about to appoint such receiver or trustee."

Mr. CLARK. I would not have the slightest objection to that, and more than that, I think that such an amendment ought to be adopted. The Commission ought to be made a party, given the right to be heard, given a standing in court, but it should not be made mandatory on the court to accept the Commission's ukase.

Mr. MCKELLAR. I think the language which the Senator from Montana himself has suggested, which he showed me a while ago, will cover that point.

"In any proceeding in which the Commission is appointed trustee or receiver the Commission shall designate a member or officer thereof to carry out the directions or orders of the court."

Why would that not cover it?

Mr. WHEELER. No; it would not quite cover it.

Mr. MCKELLAR. If the Senator will change it, I am quite sure we can agree on it.

Mr. CLARK. Mr. President, will the Senator from Tennessee yield?

Mr. MCKELLAR. I yield.

Mr. CLARK. If I understand the intention of the Senator from Montana, it is that in any proceeding in which a receiver is applied for, before the receiver shall be appointed the Commission shall be notified and given an opportunity to be heard.

Mr. McKELLAR. I have no objection to that.

Mr. BARKLEY. That amendment ought to be worked out carefully.

Mr. McKELLAR. That can be done later.

Mr. CLARK. That amendment should be carefully drafted.

Mr. WHEELER. I will work it out, Mr. President. That is the language which the Senator from Washington [Mr. SCHWELLENBACH] suggested to me.

Mr. CLARK. Yes.

Mr. GORE. Does that mean that the court is to appoint someone else than the Commission or a member of the Commission?

Mr. McKELLAR. No.

Mr. GORE. I wish to suggest that the Senator include in the final draft some amendment including compensation which shall be paid receivers, whether appointed by the court or whether the Commissioners act as receivers.

Mr. McKELLAR. I think the best way is to let this language be stricken out, as proposed in the pending amendment, and then if there is other language offered it can be taken up later.

Mr. GORE. That will require a motion to reconsider.

Mr. McKELLAR. I ask that a vote may be had upon the pending amendment.

Mr. HASTINGS. May we have the amendment stated?

The PRESIDING OFFICER. The amendment will be stated.

The CHIEF CLERK. It is proposed on page 50, line 22, to strike out the words—

"The Commission shall be entitled to such reasonable compensation for its services as trustee or receiver in any proceeding as the court may allow."

Mr. BORAH. Mr. President, what copy is the clerk reading ffom?

Mr. MCKELLAR. Mr. President, the language is exactly the same in whatever copy the Senator has. The language has not been changed at all.

Mr. STEIWER. In one copy it appears on page 53.

Mr. BORAH. The clerk said "page 50."

Mr. MCKELLAR. It is on page 53 in one copy and on page 50 in the other.

Mr. BORAH. May we have the amendment again stated?

The CHIEF CLERK. It is proposed, on page 50 of the print which has no amendments on it, line 22, to strike out the following language:

"The Commission shall be entitled to such reasonable compensation for its services as trustee or receiver in any proceedings as the court may allow."

The PRESIDING OFFICER. Is there objection to the amendment of the Senator from Tennessee?

Mr. BORAH. I have no objection to the amendment, but I should like to know where it is in the bill.

Mr. MCKELLAR. I will show it to the Senator. It appears on page 50 of the original draft of the bill.

The PRESIDING OFFICER. Without objection, the amendment is agreed to.

Mr. MCKELLAR. Mr. President, I move to strike out, on page 52, lines 15, 16, and 17, the words:

"shall have power, and, at the request of the Commission, it shall be the duty of the court to"—

and insert the word "may."

Mr. BARKLEY. Mr. President, a parliamentary inquiry.

The PRESIDING OFFICER. The Senator will state it.

Mr. BARKLEY. Has the Senator secured reconsideration of the vote by which this amendment was adopted on Friday?

Mr. MCKELLAR. Is that necessary?

Mr. BARKLEY. Yes.

Mr. MCKELLAR. I ask unanimous consent to reconsider the vote by which this amendment was adopted on Friday for the purpose of offering my amendment.

The PRESIDING OFFICER. The Senator from Tennessee asks unanimous consent that the vote by which the amendment was agreed to on Friday be reconsidered. Is there objection? The Chair hears none, and the vote is reconsidered.

Mr. MCKELLAR. Now, Mr. President, ask that the clerk state the amendment.

Mr. HASTINGS. May I suggest to the Senator that it seems to me the Senate ought either to agree to follow the original bill which was reported by the committee or to follow the bill as reprinted.

Mr. MCKELLAR. In this case we have to take the reprinted bill, because my amendment is in the form of an amendment to an amendment which was adopted the other day by the Senate.

Mr. CLARK. I think the Senator is in error as to that. I think the bill, with the amendments thereto, was reprinted for the convenience of the Senate, and that, in considering the bill, the Senate should refer to the original bill.

The PRESIDING OFFICER. The Chair will state that the original bill is used at the desk. The amendment offered by the Senator from Tennessee will be stated.

The CHIEF CLERK. On page 49, on motion of Mr. Wheeler, the following amendment was agreed to:

"(f) In any proceeding in a court of the United States, whether under this section or otherwise, in which a receiver or trustee is appointed for any registered holding company or any subsidiary company thereof, the court shall have power, and, at the request of the Commission, it shall be the duty of the court to constitute and appoint the Commission as sole trustee or receiver subject to the direction and orders of the court."

In that amendment, the vote on agreeing to which has been reconsidered, Mr. McKellar proposes to strike out the words, "shall have power, and, at the request of the Commission, it shall be the duty of the court to" and insert the word, "may", so as to read:

"the court may constitute and appoint"—

And so forth.

Mr. GORE. Mr. President, I ask the clerk to read the words following the word "constitute."

The Chief Clerk read as follows:

"Constitute and appoint the Commission as sole trustee or receiver, subject to the directions and orders of the court."

Mr. GORE. I move to amend by inserting after the word "Commission" the words "or any member thereof." I do that merely in the interest of simplifying the mechanics of the procedure.

Mr. WHEELER. I hope that will not be done, because I think it is much better that the Commission be appointed and then the Commission may select one of its own members. I have worked that out with the

Senator from Tennessee and we agreed upon an amendment which is satisfactory, and I think it is much better, if I may say so, not to add the words suggested by the Senator from Oklahoma.

Mr. McKellar. I think it will cover the very point the Senator from Oklahoma has in mind.

Mr. Gore. Very well; I am not familiar with the amendment; and, in view of that statement, I will withdraw mine. My assumption was, however, that the Commission would recommend one of its members to the court and that such member would be appointed. My purpose was to simplify the machinery.

Mr. Steiwer. Mr. President, I merely wish to observe that if the amendment suggested by the Senator from Tennessee shall be agreed to, the difficulty, partially if not entirely, disappears because it is simply permissive. The court is not bound to appoint the Commission. It may then appoint the Commission or any member of the Commission or possibly more than one member of the Commission, if the court, in its judgment, should deem it wise to do so. So if the amendment shall be agreed to by the Senate, the difficulty suggested by the Senator from Oklahoma will no longer exist. I think that affords an argument in behalf of the amendment of the Senator from Tennessee.

The Presiding Officer. The question is on the amendment of the Senator from Tennessee to the amendment of the Senator from Montana.

The amendment to the amendment was agreed to.

Mr. McKELLAR. Mr. President, the chairman of the committee suggested in conference with me——

The PRESIDING OFFICER. The question now is on agreeing to the amendment as amended.

Mr. McKELLAR. Before that is done, let me say that the amendment I am about to suggest is an amendment to that section. I will ask the Senator from Montana, if he desires to have inserted the following words?—

"In any proceeding in which the Commission is appointed trustee or receiver the Commission shall designate a member or officer thereof to carry out the directions and orders of the court."

Mr. WHEELER. I think that would be a good provision.

Mr. McKELLAR. I offer the amendment which I ask the clerk to state.

The PRESIDING OFFICER. The amendment will be stated.

The CHIEF CLERK. On page 50, after line 24, it is proposed to insert:

"In any proceeding in which the Commission is appointed trustee or receiver the Commission shall designate a member or officer thereof to carry out the directions and orders of the court."

Mr. BARKLEY. Mr. President, I suggest that the word "may" be used instead of the word "shall." It might be possible in some cases that the whole Commission might desire to act.

Mr. McKELLAR. I have no objection to that modification.

The PRESIDING OFFICER. The Chair is advised that the parliamentary situation is

such that the amendment now offered by the Senator from Tennessee does not relate to the amendment of the Senator from Montana, which has been amended. Therefore, the last amendment offered by the Senator from Tennessee, is not properly in order at this time.

Mr. McKELLAR. The section has been reconsidered, and is still reconsidered.

The PRESIDENT pro tempore. The Senate only reconsidered the amendment.

Mr. McKELLAR. I ask unanimous consent that the section may be reconsidered, in order that I may present the amendment.

The PRESIDING OFFICER. The entire section does not have to be reconsidered. The question now properly before the Senate is on agreeing to the amendment of the Senator from Montana as amended by the amendment of the Senator from Tennessee. When action shall have been taken on that, then the Senator from Tennessee may present the amendment, and it will be in order.

Mr. BARKLEY. Let us agree on the amendment as amended.

The PRESIDING OFFICER. The question is on agreeing to the amendment of the Senator from Montana as amended by the amendment of the Senator from Tennessee.

The amendment to the amendment was agreed to.

Mr. McKELLAR. Now I offer the amendment to which I have referred.

Mr. LONG. The amendment is now unnecessary, is it not?

The PRESIDING OFFICER. The question now is on the amendment offered by the Senator from Tennessee, which the clerk will state.

The CHIEF CLERK. On page 50, after line 24, it is proposed to insert the following:

"In any proceeding in which the Commission is appointed trustee or receiver, the Commission may designate any member or officer thereof to carry out the directions and orders of the court."

Mr. HASTINGS. Mr. President, may I suggest to the Senator from Tennessee that it seems to me that is a very objectionable amendment. The suggestion is made that the court, as I understand, may appoint, but is not required definitely to appoint, the Commission to act as receiver.

Mr. MCKELLAR. The amendment does not require the appointment of the Commission; but if the court should appoint the Commission, the Commission could select the person on motion to the court.

Mr. HASTINGS. Of course, the court could appoint anybody who had authority under a statute or otherwise to go and do the particular job for the Commission. In other words, it would make it certain that any careful court under no circumstances would appoint the Commission. I am not opposed to compelling them to appoint the Commission.

Mr. WHEELER. Mr. President, if there is any objection to the amendment of the Senator from Tennessee, let me say that I do not care anything about it at all, and I am perfectly willing that the amendment shall not be adopted. I have no interest in it.

Mr. MCKELLAR. If there is any objection to it, I will not insist upon it. The amendment was just a part of the agreement I made with the chairman of the committee.

Mr. WHEELER. If there is any objection to it, I will ask the Senator from Tennessee to withdraw it.

Mr. MCKELLAR. I withdraw the amendment.

The PRESIDING OFFICER. The amendment is withdrawn.

Mr. CONNALLY. Mr. President, I desire to offer two amendments, which I ask to have lie on the table.

The PRESIDING OFFICER. The amendments will be received, printed, and lie on the table.

Mr. GORE. Mr. President, the withdrawal of the amendment of the Senator from Tennessee raises a point which I suggested a few moments ago, that the amendment offered by the Senator from Tennessee should be so amended that the court could appoint either the Commission or any member of the Commission. Then the commissioner appointed by the court would be an agency or officer of the court. The amendment just withdrawn would have enabled the Commission when once appointed by the court virtually to have selected the receiver for the court. It seems to me it would simplify the proceedings if the court were invested with the discretion of appointing as receiver either the whole Commission or any member of the Commission, it all being permissive, because I am not certain that we can dictate to the court whom it shall select as receiver.

The PRESIDING OFFICER. The bill is still before the Senate and open to amendment.

Extracts from the Congressional Record, Vol. 79, 74th Cong., 1st Sess., p. 8943:

Mr. BONE. Mr. President, I have just reentered the Chamber, and I understand that a moment ago an amendment was adopted which restricts the appointment of a receiver in insolvency proceedings, or rather prevents the naming of the Commission as trustee or receiver. I regret

that has been done. I feel that some of my brethern may live to regret it.

The Associated Gas & Electric Co., one of the largest outfits in the country, is now facing insolvency proceedings. This movement may result in the naming of one of the men connected with that organization as trustee or receiver. If there be any untoward results arising from such a receivership, this body will surely have to answer for it to the people of the country. The thing will smell to high heaven if they pursue the method so frequently pursued in cases of that kind. We might as well be advised now. If the Associated Gas & Electric Co. should get into trouble and there should be a scandal, I want Senators to remember what I say now on the floor of the Senate today, because I am going to remind them of it. This might easily project itself into a situation that would be a national scandal. We should allow the Government through its own agency to handle the matter if it reaches the stage of receivership.

We had a Federal judge before us not long ago under impeachment proceedings, and we have seen how tainted and corrupt some of these receivership matters may be. When a judge appoints a trustee or a receiver, he frequently names one of his own friends, and then he has a friend practicing law before him. There is not a lawyer in this body who has not seen that thing occur time after time. We almost impeached a Federal judge for doing that identical thing. He should have been impeached. I voted for his impeachment. I think a court ought to be in a class with Caesar's wife—above reproach, above suspicion—and some of our courts have not been above

reproach or above suspicion. If there is any scandal connected with this Associated Gas affair, Members of the United States Senate who voted to remove vital receivership control from the hands of the Commission are going to have to bear their share of the moral obloquy resulting from that proceeding, if the poor security holders are rooked, and we might have done something to prevent it, and did not.

Mr. LONG. Mr. President, I did not understand we struck out the appointment of the Commission as trustee or receiver. I understand we merely changed the word "shall" to "may."

Mr. BONE. I want the people of the country to know, after years and years of maladministration of the affairs of these companies, that we come here now with a bill to try to correct some of the abuses, and step by step by this process of attrition, we are tearing the heart out of the bill.

Mr. LONG. Let us quit tearing.

Mr. BLACK. Mr. President, I desire to ask the Senator from Washington a question. Is that the amendment which changed the word "shall" to "may"?

Mr. BONE. Yes.

Mr. BLACK. Does not the Senator, from experience and observation of his own, know that if it is left to the court to appoint receivers, the court will never appoint Government agencies where those agencies are already drawing their salaries from the Government? The natural result and the inevitable result would be that in all instances the receiver in the future, as in the past, will be someone whom the court wants to appoint. Is not that correct?

Mr. BONE. That is the record which has been disclosed by one of our Senate committees. The receivership racket all over the country has become a stench. It is a reproach to our system of administering the law. If Associated Gas cracks up and a bad smell emanates from the receivership, they must not walk away from their responsibility, but they must step up and shoulder it like men. We have tried to secure a form of receivership in these cases that would remove the evils and weaknesses of the present system, and apparently we have failed through this amendment.

Mr. BORAH. Mr. President, I do not know that I understood the Senator as to which particular amendment he was discussing. To what amendment did the Senator refer?

Mr. BONE. I understood the amendment had been adopted which struck out of the bill the requirement that the Commission itself should act as receiver. I think that is wrong.

Mr. BORAH. I did not understand that the Senate struck out the provision that the Commission might be appointed, but my understanding was that it was made discretionary. Is that correct?

Mr. BONE. That is correct.

Mr. WHEELER. Let me say to the Senator that in line with what the Senator from Washington [Mr. SCHWELLENBACH] called attention to, and what I called the attention of two or three Senators to a moment ago, I propose to add a proviso saying that in any such proceeding the court shall not appoint any person other than the Commission as trustee or receiver without notifying the Commission, and giving it an

opportunity to be heard before making any such appointment.

That is in accordance with the suggestion of the Senator from Washington [Mr. SCHWELLENBACH], and two or three other Senators. I think it is very helpful to the bill, and will prevent the court from just stepping in and appointing somebody offhand, without giving any consideration at all to the matter. The Commission will have a right to be heard on the matter.

Is there an amendment pending at the present time?

The PRESIDING OFFICER. There is no amendment pending at the present time.

Mr. BORAH. Mr. President, do I understand that the Senator has offered that amendment, or that he will offer it?

Mr. WHEELER. I am going to offer it in a few moments.

Extracts from the Congressional Record, Vol. 79, 74th Cong., 1st Sess., p. 8944:

Mr. WHEELER. Mr. President, I send to the desk an amendment of which I spoke a moment ago, and which I have just worked out. It is to add certain language after the word "appointed", on page 50, line 2:

The PRESIDING OFFICER. The Senator from Montana offers an amendment which will be stated.

The CHIEF CLERK. On page 50, line 2, after the word "appointed" and before the period, it is proposed to insert:

"And in any such proceeding the court shall not approve any person other than the Commission as trustee or receiver without notifying the Commission and giving it an opportunity to be heard before making any such appointment."

Mr. McKELLAR. Mr. President, is that the amendment which the Senator has worked out?

Mr. WHEELER. That is the amendment I have worked out, as suggested.

U. S. GOVERNMENT PRINTING OFFICE: 1940